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Supreme Court of the United States

October Term, 1932

No. 27

THE STEWART DRY GOODS COMPANY, . . Appellant
Vs.
JOHN B. LEWIS, ET AL., ... Appellees

No. 28

FRED LEVY, ET AL., ... Appellants
Vs.
JOHN B. LEWIS, ET AL., ... Appellees

No. 29

J. C. PENNEY COMPANY, ... Appellant
Vs.
JOHN B. LEWIS, ET AL., ... Appellees

No. 30

KROGER GROCERY & BAKING COMPANY, . Appellant
Vs.
JOHN B. LEWIS, ET AL., ... Appellees

BRIEF FOR APPELLEES

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SCHEDULE OF CONTENTS

INTRODUCTORY STATEMENT 1-2

ARGUMENT 3-136

PART ONE 3-18

Pages

SECTION 10 OF THE CHALLENGED ACT CONSTITUTES A CONSENT ON THE PART OF THE STATE OF KENTUCKY TO BE SUED AT LAW IN STATE OR FEDERAL COURTS FOR A RECOVERY OF THE TAX IMPOSED AND PAID UNDER THE ACT AND PROVIDES THE APPELLANTS WITH A PLAIN, ADEQUATE AND COMPLETE REMEDY AT LAW 3-18

Dows v. Chicago, 11 Wall 108 3-4-5
Hennawinkle v. Georgetown, 15 Wall 547 3
Milwaukee v. Koofner, 116 U. S. 219 3
Shelton v. Platt, 139 U. S. 591 3
Allen v. Pullman Palace Car Co., 139 U. S. 658 3
Arkansas B. L. Assn. v. Madden, 175 U. S. 269 3-6
Cruikshank v. Bidwell, 176 U. S. 73 3-6
Indiana Mfg. Co. v. Koehne, 188 U. S. 681 3
Boise Artesian H. & C. Water Co. v. Boise City, 213 U. S. 76 3-4-6
Singer Sewing Machine Co. v. Benedict, 229 U. S. 481 3
U. S. Revised Statute, Sec. 3224, Sec. 126, Title 126, U. S. C. A. 4
State Railroad Taxes, 92 U. S. 275 4
Kentucky Gross Sales Tax Act, Sec. 10 6-7

Pages

A. The Taxpayer Who Pays Under Protest Is Not Required by Section 10 to Accept a State Warrant on a Bankrupt Fund 7-12

Indiana Mfg. Co. v. Koehne, 188 U. S. 681 9
Atchison T. & S. F. R. Co. v. O'Conner, 223 U. S. 280 9
Allen v. Pullman Palace Car Co., 139 U. S. 658 9
Arkansas B. & L. Assn v. Madden, 175 U. S. 269 10
State Budget Commission v. Lebus, 244 Ky. 700 10
Rhea v. Newman, 153 Ky. 604 10
Bosworth, Treas. v. Shuck, 118 Ky. 458 10
Chapter 20, Acts of 1932 General Assembly 10
Chapter 13, Acts of 1926 General Assembly 11
Chapter 22, Acts of 1924 General Assembly 11

B. The State by Section 10 of the Challenged Act Waived Its Immunity and Consented to be Sued in Both State and Federal Courts 12-17

North Carolina v. Temple, 134 U. S. 32 13
N. Y. Guarantee Co. v. Steele, 134 U. S. 230 13
Highway Commission v. Utah Co., 278 U. S. 194 13
Singer Sewing Machine Co. v. Benedict, 229 U. S. 481 13-16
C. B. & Q. R. Co. v. Osborne, 265 U. S. 14-16 13
Risty v. Chicago R. I. & P. Ry. Co., 270 U. S. 278-288 13
Shelton v. Platt, 139 U. S. 591 14
Allen v. Pullman Palace Car Co., 139 U. S. 658 14
Kentucky Gross Sales Tax Act, Sec. 10 14-15
Kentucky Statutes, Section 162 15
Greene County v. Daniel, 102 U. S. 187 16
Davenport v. Dodge County, 105 U. S. 237 16
Southern Ry. Co. v. Query, 21 Fed. (2) 333 17
25 C. J., p. 742 17
Gunter v. Atlantic Coast Line Railroad, 200 U. S. 273 17

PART TWO

	Pages
PASSAGE OF THE ACT	18-21
ANALYSIS OF APPELLEES' EVIDENCE	21-89
I. The Recent Shift in American Economic Life and Consequent Increased Need for Government Service.	
U. S. Department of Commerce, Survey of Current Business, August 1930	23
U. S. Department of Commerce, Financial Statistics of Cities, 1927	25
U. S. Department of Commerce, Financial Statist of States, 1927	25
Gross Sales Tax Act of West Virginia	27
Gross Sales Tax Act of Georgia	27
Maine v. Grand Trunk Railroad Company of Canada, 142 U. S. 217	27
Bureau of Business Research of the University of Iowa	28
II. Rate Structure Provided in the Gross Sales Tax Statute	29-46
1. PRECEDENTS FOR THE KENTUCKY GROSS SALES TAX	29-32
Revised Statutes of Maine, 1930	30-31
Maine v. The Grand Truck Railway, supra	31
2. THE RELATION OF THE GROSS SALES TAX ACT TO OTHER LICENSE TAXES	32-40
Sec. 4, Gross Sales Tax Act	32
Code of Virginia, 1928	33
3. CHARACTER OF GRADUATION PROVIDED	40-44
Cooley on Taxation, 4th Ed., p. 716	42
Louisville Gas and Electric Company v. Coleman, 277 U. S. 32	42
West Virginia Gross Sales License Tax	43
4. FAILURE OF APPELLANTS' SUBTERFUGES	44-47

Pages

III. **Analysis of the Relation of Operating Statistics to Net Income, Showing That the Larger the Gross Sales the Greater the Net Income** 47-69

1. ECONOMICS OF LARGE-SCALE RETAILING 47-50

2. INCREASE IN NET INCOME WITH INCREASE IN SALES 50-51

3. RELATION OF RATE STRUCTURE PROVIDED IN THE GROSS SALES TAX STATUTE TO ABILITY TO PAY 51-55

4. PRECEDENTS FOR ADJUSTMENT OF RATE STRUCTURE TO MERCHANDISING CONDITIONS 55-58
City of Newport v. Frankel, 192 Ky. 408 57

5. RELATION OF RATE STRUCTURE TO NUMBER OF TAXPAYERS AND BURDEN OF TAX IMPOSED 58-67
Cooley on Taxation, 4th Ed., Vol. 1, p. 717 65

6. GENERAL CONFORMITY OF RATE STRUCTURE TO DEMONSTRATED CHARACTER OF MERCHANDISING 67-69

IV. **The Existing Tax System of Kentucky Tends to Tax Small Retainers More Heavily in Proportion to Sales Than Larger Ones** 69-76

1. THE GENERAL SITUATION 69-73
Section 171, Kentucky Constitution 73

2. REASONS FOR THE SITUATION EXISTING PRIOR TO THE PASSAGE OF THE GROSS SALES TAX ACT.

U. S. Department of Agriculture, Technical Bulletin No. 172 73
Harvard Bureau of Business Research 74

V. **Comparison of Tax-Paying Ability of Voluntary Chains of Small Merchants with Large-Scale Retailers** 77-81

Pages

VI. **The Question of Confiscation** 81-89

1. SITUATION IN GENERAL IN THE LIGHT OF PRECEDENT AND OF MERCHANDISING CONDITION 81-84
Maine v. Grand Trunk, 142 U. S. 217 77

2. CONFISCATION IN THE CASE OF THE KROGER COMPANY 84-88

3. FAIRNESS OF TAX RATE IN PRACTICE—NOT CONFISCATORY OF PROPERTY OR OF MAJOR PART OF INCOME OF ANY TYPICAL MERCHANT 88-89

Gordon v. City of Lexington, 138 Ky. 442 89

ANALYSIS OF APPELLANTS' EVIDENCE 89-94

I. **Evidence Concerning Payment of Kentucky Warrants** 90

II. **The Question of Fire and Police Hazard** 90

III. **Expert Evidence** 90-93

Harvard Bureau of Business Research Bulletin, 78, p. 8 91

IV. **Analysis of Returns to the Kentucky Tax Commission** 93-94

THE LAW OF THE CASE ON THE MERITS OF THE TAX 94-135

I. **The Provisions of the Act Are Not Arbitrary or Discriminatory in Violation of the Constitution of the United States or the Constitution of Kentucky** 94-118

Hager v. Walker, 128 Ky. 1, 107 S. W. 254 94
City of Louisville v. Sagalowski, 124 S. W. 339 94
Schuster v. Louisville, 124 Ky. 189, 89 S. W. 689 94
Brown-Forman Co. v. Commonwealth, 125 Ky. 402, 101 S. W. 321 94
Strater Bros. v. Commonwealth, 117 Ky. 604, 78 S. W. 871 94

	Pages
Constitution of Kentucky, Section 171	95
Young v. City of Lexington, 235 Ky. 822	95-96
City of Louisville v. Sagalowski, supra	97
Quong Wing v. Kirkendall, 223 U. S. 63	98
Gordon v. City of Louisville, 133 Ky. 442, 128 S. W. 327	99-100
Kentucky Gross Sales Tax Act	100
Hager, Auditor v. Walker, supra	101
Gordon v. City of Louisville, supra	102-103
Strater Bros. v. Commonwealth, supra	104
Brushader v. Union Pacific Railroad Co., 240 U. S. 1	105
Clark v. City of Titusville, 184 U. S. 329	105
Magoun v. Illinois Trust & Savings Bank, 170 U. S. 283	106-109
Metropolis Theatre v. City of Chicago, 228 U. S. 61	109-110
Newton v. Atchison, 31 Kans. 151; 47 Am. Rep. 486	110
Newcastle v. Cutler, 156 Sup. Ct. Rep. 612	110
Goldsmith v. Huntsville, 120 Ala. 182	110
Cowart v. Greenville, 67 S. C. 35	110
Saks v. Birmingham, 120 Ala. 190; 24 So. 728	110
Fickler v. Taxing District, 145 U. S. 1	110
Ex Parte Mount, 66 Calif. 448	111
San Luis Obispo Co. v. Greenburg, 120 Cali. 300	111
Ex Parte Hurl, 49 Calif. 557	111
Knisley v. Cotterel, 196 Pa. 614, 50 L. R. A. 86	111
Williamsport v. Wenner, 172 Pa. 173	111
Allentown v. Gross, 132 Pa. 319	111
Kentucky Gross Sales Tax Act, Sec. 4	111
Greene v. E. H. Taylor, Jr. & Sons, 184 Ky. 739, 212 S. W. 924	112
Kentucky Statutes, Section 4189a	112
Kentucky Statutes, Section 4214a	112-114
State Board of Tax Com'rs of the State of Indiana v. Jackson, 283 U. S. 527-553	115-118

Pages

II. The Provisions of the Act Are Not Confiscatory, Oppressive or Prohibitory in Violation of the 14th Amendment to the Constitution of the United States or the Constitution of Kentucky 118-132

1. The Actual Rate of Taxation Under the Act 118
14th Amendment to the Constitution of the United States 122
Palestine Telephone Co. v. Palestine, (D. C. Texas, 1924), 1 Fed. (2) 349 122
Shaffer v. Carter, 252 U. S. 37 123
Travis v. Yale Mfg. Co., 252 U. S. 60 123
United States Constitution, 14th Amendment 123
Tinsley v. Anderson, 171 U. S. 106 123
Williams v. Arkansas, 217 U. S. 79 123
Field v. Barber Asphalt Paving Co., 194 U. S. 621 123
Atlantic Coast Line R. R. Co. v. Coachman, 59 Fla. 130 123
Owen Co. Burley Tobacco Society v. Brumback, 180 Ky. 137 123
State v. Taylor, 224 Mo. 393 123
State v. Standard Oil Co., 218 Mo. 1, affirmed 224 U. S. 270 123
State v. Texas, 143 S. W. 223 123
Marshall v. Foote, 252 Pa. 1075 123
Priviso School v. Oak Park, 153 N. E. 369 123
Stone v. City of Jefferson, 293 S. W. 780 123
Camden Fire Ass'n v. Haston, 153 Tenn. 675 123
State v. Quigg, 114 So. 859 123
Watson v. Nevin, 86 Ky. 492, affirmed 128 U. S. 582 123
Home Insu. Co. v. New York, 34 U. S. 594 123
Southwestern Oil Co. v. Texas, 217 U. S. 114 124
Michigan Telephone Tax Cases, 185 Fed. 634, affirmed 229 U. S. 322 124

Pages

State v. Farmers', Etc., Sav. Bank, 114 Mins. 95, 130 N. W. 445 124
Magnolia Bank v. Pike Co., 72 So. 697 124
United New Jersey R., etc., Co. v. Parker 69 Atl. 239 124
Bergen, etc., R. Co. v. State, 67 Atl. 668 124
Territory v. Pinney, 15 N. Mex. 625 124
In Re Gross Production Tax of Wolverine Oil Co., 154 Pac. 362 124
Heisler v. Thomas Colliery Co., 274 Pa. 448 124
State v. Galveston, Etc., R. R. Co., 100 Texas 152 124
Bells Gap R. R. Co. v. Penn., 134 U. S. 237 124
St. Louis, etc., R. R. Co. v. Davis, 132 Fed. 629 125
Smith v. Stevens, 173 Ind. 564 125
U. S. Constitution, Fifth Amendment 125
In Re Mahon, (D. C. Ky. 1888), 24 Fed. 525, affirmed, 127 U. S. 700 125
People v. Gifford, 54 Calif. Appeals 182 125
Lewis v. State Board of Examiners, 162 Ga. 263 125
Bemis v. Guirl Drainage Co., 182 Ind. 36 125
Nectow v. Cambridge, 157 N. E. 618 125
New York Co. v. N. Y. C. & H. R. Co., 267 Pa. 64 125
U. S. v. Armstrong, 265 Fed. 683 125
Davidson v. New Orleans, 96 U. S. 97 126
Mo. Pac. Ry. v. Hunes, 115 U. S. 512 126
Lecker v. Texas, 139 U. S. 462 126
Giozza v. Tiernary, 148 U. S. 657 126
U. S. Yount (D. C. Pa. 1920), 267 Fed. 861 126
Stanton v. Baltic Mining Co., 240 U. S. 103 126
Pacific American Fisheries v. Territory of Alaska, 269 U. S. 269 126-127
National Biscuit Co. v. Federal Trade Com'n, 299 Fed. 733 130-131

Pages

III. **The Act Is Not Violative of Article 1, Sec. 8, Subsec. 3, of the Constitution of the United States, Commonly Known as "The Interstate Commerce Clause"** 132-135

United States Constitution, Art. 1, Sec. 8, Subsection 3 132
Duncan v. State, 105 Ga. 457 132
Kehrer v. Stewart, 117 Ga. 467 132
Muskegon v. Zeeryp, 134 Michigan 181 132
Emert v. Missouri, 46 U. S. 396 132
U. S. Constitution, 14th Amendment, Sec. 1 133
American Fertilizing Co. v. Bd. of Agriculture, (Circuit Court of Appeals of North Carolina) 43 Fed. 609 133
Kentucky Gross Sales Tax Act, Sec. 1 134
Moore et al., v. State Board of Charities & Corrections, 239 Ky. 729, 40 S. W. (2d) 349 135

AUTHORITIES CITED

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Allentown v. Gross, 132 Pa. 319, 192 Atl. 269.
American Fertilizer Co. v. Board of Agriculture (Circuit Court of Appeals of N. C.), 43 Fed. 609.
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Arkansas B. & L. Assn. v. Madden, 175 U. S. 269.
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Bergen, Etc., Railroad Co. v. State (1907), 74 N. J. Law 771, 67 Atl. 668.
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City of Louisville v. Sagalowski, 124 S. W. 339.
City of Irvine v. Bergman, 220 Ky. 804, 295 S. W. 1041.
City of Newport v. Frankel, 192 Ky. 408.
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C. B. & Q. R. Co. v. Osborne, 265 U. S. 14-16.
25 C. J., p. 742.
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Gunter v. Atlantic Coast Line Railroad, 200 U. S. 273.
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Kentucky Gross Sales Tax Act, Sec. 10.
Kentucky Acts of 1932 General Assembly, Chapter 20.
Kentucky Acts of 1926 General Assembly, Chapter 13.
Kentucky Acts of 1924 General Assembly, Chapter 22.
Kentucky Constitution, Secs. 171-181.
Kentucky Statutes, Section 162.
Kentucky Statutes, Sections 4189a, 4981c, 4214a, 162.
Knisely v. Cotterel, 196 Pa. 614, 50 L. R. A. 86, 40 Atl. 861.
Leeker v. Texas, 139 U. S. 462.
Lewis v. State Board of Examiners (1926) 162 Ga. 263, 133 S. E. 469.
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Main v. Grand Trunk R. R. Co. of Canada, 142 U. S. 217.
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Marshall v. Foote (California 1927), 252 P. 1075.
Metropolis Theatre v. City of Chicago, 288 U. S. 61.
Magnolia Bank v. Pike County (1916), 111 Miss. 857, 72 So. 697.
Merchants Ice and Cold Storage Co. v. Comm., 154 Ky. 453, 157 S. W. 717.
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BRIEF FOR APPELLEES

MAY IT PLEASE THE COURT:

INTRODUCTORY STATEMENT

The appellants here were complainants below. They filed four separate equity suits in the District Federal Court, challenging the validity of the Kentucky "Gross

Sales Tax Law" (Sessions Act 1930, Chapter 149). By the bills of complaint the appellants sought relief through applications for interlocutory and permanent injunctions against the enforcement of the challenged Act, upon the grounds that the enforcement of the Act was in violation of the equal protection and due process clauses of the Federal Constitution and imposed a direct burden upon inter-state commerce. The appellees filed motion to dismiss the bills of complaint, upon the ground that the appellants had a plain, adequate and complete remedy at law. They also filed answers to each of the bills, presenting an issue as to the validity of the challenged Act.

The court below held that the complainants had a plain, adequate and complete remedy at law under the provisions of Section 10 of the challenged Act and "declined to consider any issue or question raised herein except the single question as to the adequacy of the remedy at law and solely for the reasons stated in its said opinion sustains the motion of defendants to dismiss the bill and denies to the plaintiffs a permanent injunction or any injunctive or other relief prayed for by it."

These appeals are before this Court to reverse the judgment of the lower court denying appellants' motions for interlocutory injunctions and dismissing appellants' bills of complaint.

We are materially handicapped in the preparation of our brief, for the reason we have not been furnished with copy of appellants' brief on this date, Oct. 14, 1932.

ARGUMENT

PART ONE

SECTION 10 OF THE CHALLENGED ACT CONSTITUTES A CONSENT ON THE PART OF THE STATE OF KENTUCKY TO BE SUED AT LAW IN STATE OR FEDERAL COURTS FOR A RECOVERY OF THE TAX IMPOSED AND PAID UNDER THE ACT AND PROVIDES THE APPELLANTS WITH A PLAIN, ADEQUATE AND COMPLETE REMEDY AT LAW.

Appellants sought by injunctive relief to escape payment of the tax on the theory that the provisions of the challenged Act are in violation of the Constitution of the United States and the Constitution of Kentucky.

That the illegality of a state or municipal tax is not of itself a ground for equitable relief authorizing a Federal Court to grant an injunction against its collection is well settled by a long line of decisions of this Court. This was so held in the following cases:

Dows v. Chicago, 11 Wall 108;
Hennawinkle v. Georgetown, 15 Wall 547;
Milwaukee v. Koofner, 116 U. S. 219;
Shelton v. Platt, 139 U. S. 591;
Allen v. Pullman Palace Car Co., 139 U. S. 658;
Arkansas B. & L. Assn. v. Madden, 175 U. S. 269;
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Boise Artesian H. & C. Water Co. v. Boise City, 213 U. S. 76;
Singer Sewing Machine Co. v. Benedict, 229 U. S. 481.

Injunctive relief against the collection of an alleged illegal state or municipal tax was denied in each of these cases. The relief was denied because the sole basis presented for granting the injunction was the illegality of

the tax. Section 723 U. S. Revised Statutes, Section 384, Title 28 U. S. C. A. forbids suits in equity where a plain, adequate and complete remedy exists at law. There is a special reason why injunctive relief should not be granted against the collection of a state tax on the ground of its illegality. The reason is stated in *Dows* v. *Chicago*:

> "It is upon taxation that the several states chiefly rely to obtain the means to carry on their respective governments and it is of the utmost importance to all of them that the modes adopted to enforce the taxes levied should be interfered with as little as possible."

In the case of *Boise Artesian H. & C. Water Co.* v. *Boise City* it was said:

> "An examination of the decisions of this court shows that a proper reluctance to interfere by prevention with the fiscal operation of the state government has caused it to refrain from so doing in all cases where the federal rights of the person could otherwise be preserved unimpaired."

So far as National taxes are concerned Sec. 3224 U. S. Rev. Stat., Section 126, Title 26, U. S. C. A. prohibits absolutely an injunction against their collection. Concerning this provision it was said in State Railroad Taxes, 92 U. S. 275,

> "And though this was intended to apply alone to taxes levied by the United States it shows the sense of Congress of the evils to be feared if courts of justice could in any case interfere with the process of collecting the taxes on which the government depends for its continued existence. It is a wise policy. It is founded on the simple philosophy derived from the experience of ages that the payment of taxes has to be enforced by summary and stringent means against a reluctant and often adverse sentiment; and to do this successfully other instru-

mentalities and other modes of procedure are necessary than those which belong to courts of justice."

Concerning the system prevailing in the National Government it was said:

> "There is no place in this system for an application to a court of justice until after the money is paid."

As to what must appear in order that it may be said that such remedy does not exist is thus set forth in *Dows* v. *Chicago*:

> "There must be some special circumstances attending a threatened injury of this kind, distinguishing it from a common trespass, bringing the case under some recognized head of equity jurisdiction before the preventive remedy of injunction can be had."

Again:

> "It must appear that the enforcement of the tax would lead to multiplicity of suits, or produce irreparable injury, or where the property is real estate, throw a cloud upon the title of the complainant before the aid of a court of equity can be invoked. In the cases where equity has interfered in the absence of these circumstances, it will be found upon examination that the question of jurisdiction was not raised or has been waived."

And again:

> "Numerous cases are found in the reports where jurisdiction has been taken under similar circumstances and the collection of an illegal tax restrained but our attention has not been called to any well considered case where a court of equity has interfered by injunction after its jurisdiction was questioned except upon some one of the special circumstances mentioned."

In *Boise Artesian H. & C. Water Co.* v. *Boise City*, the matter was thus put:

> "In order to give equity jurisdiction there must be shown in addition to the illegality or unconstitutionality of the tax or imposition other circumstances bringing the case under some recognized head of equity jurisdiction before the remedy by injunction can be awarded."

In *Arkansas B. & L. Association* v. *Madden*, it was said:

> "The rule is that collection of taxes under state authority will not be enjoined by a court of the United States on the sole ground that the tax is illegal, but it must appear that the party taxed has no adequate remedy by the ordinary processes of law and that there are special circumstances bringing the case within some recognized head of equity jurisdiction."

According to this, two things are essential: absence of such remedy and presence of such circumstances. In the case of *Cruikshank* v. *Bidwell*, 176 U. S. 73, the statement was:

> "It is well settled that the mere fact that a law is unconstitutional does not entitle a party to relief by injunction proceedings in compliance therewith, but it must appear that he has no adequate remedy by the ordinary processes of law or that the case is under some recognized head of equity jurisdiction."

The court below held that the appellants had a plain, adequate and complete remedy at law in Section 10 of the Challenged Act. That Section follows, in part:

> "No suit shall be maintained in any court to restrain or delay the collection or payment of the tax herein imposed upon any ground whatever, but the aggrieved taxpayer shall pay the tax as and

when due, and if paid under protest may at any time within two years from the date of such payment sue the Auditor of Public Accounts in an action at law to recover the tax so paid, with legal interest thereon, from the date of payment. If it is finally determined that said tax, or any part thereof, was wrongfully collected for any reason, it shall be the duty of the Auditor of Public Accounts, then in office, to issue his warrant on the Treasurer of the Commonwealth of Kentucky for the amount of such tax so adjudged to have been wrongfully collected together with interest thereon, and the Treasurer shall pay same out of the general fund of the State. A separate suit need not be filed for each separate payment made by any taxpayer, but a recovery may be had in one suit for as many payments as may have been made, and which are not barred by the limitation of two years herein imposed."

Appellants seek to escape the plain and specific language of this section by urging that it does not afford the taxpayer an adequate remedy at law. This contention is based upon the theory (A) the taxpayer who pays under protest is required by Section 10 to accept a state warrant on a bankrupt fund; (B) the State has not consented to being sued at law in a Federal Court.

A.

The Taxpayer Who Pays Under Protest Is Not Required by Section 10 to Accept A State Warrant on a Bankrupt Fund.

The fallacy of appellants' position is shown by the clear and unassailable opinion of the lower court, (*Kroger record*, pp. 75-82). This opinion is a complete answer to the argument of the appellants. The Act provides that "if it is finally determined that said tax or any part thereof was wrongfully collected for any reason, it shall be the duty of the Auditor of Public Accounts then in office to issue his warrant on the Treasurer of

the Commonwealth of Kentucky for the amount of such tax so adjudged to have been wrongfully collected, with interest thereon, and the Treasurer shall pay same out of the general fund of the State." By Section 9 of the Act it is provided that one-half of the taxes raised thereunder shall be "set aside and credited to the Board of Charities and Corrections for the specific purpose of repairing, maintaining and constructing permanent improvements for the use of the institutions under the control of said Board." The other half is "to be credited to a fund to be used for the specific purpose of liquidating any indebtedness of the Commonwealth."

The contention that the money paid by the taxpayer will be spent immediately is not sustained by the language used in Section 9. It is provided that the tax shall be "set aside" to the two funds mentioned in Section 9; there is no provision that it shall be spent immediately.

The argument that any warrant issued to the taxpayer will be subject to a large discount is not sustained by the record. In determining whether this position is sound it is to be taken into consideration that these warrants are negotiable, bear five per cent interest, payable semi-annually and are free from taxation and it appears from the record that they are readily marketable. It does not appear that any discount has to be made in order to dispose of them, though it is likely that a small discount has to be given. But though Section 10 provides no other method of satisfaction of judgment recovered by the taxpayer than the issuance of such a warrant, his right is not limited thereto. He is entitled to and the court may require the issuance of a warrant drawn against the specific funds created by Section 9 out of the taxes paid under the act. The moneys to the credit thereof do not belong to the state, but to the taxpayers who have created these funds. The state holds same in trust

for them and it would be a breach of trust for it to apply them to any other purpose. This position is sustained by the case of *Indiana Mfg. Co.* v. *Koehne*, 188 U. S. 681. The court held that if the county paid the state's part of the taxes collected by it into the state treasury after the filing of a petition for a refund by the taxpayer of the tax paid by him it was the duty of the county to refund same as well as its portion of the tax and it could not escape liability therefor by thereafter paying same over to the treasurer. This was on the ground, as held by the Supreme Court of the State of Indiana, that upon the filing of the petition the county became "a trustee for the claimant." That such would be the relation of the state to these funds is to be gathered also from the opinion in the case of *Atchison T. & S. F. R. Co.* v. *O'Conner*, 223 U. S. 280. It is not to be taken that the state would breach this trust. On the other hand it is to be taken that it would hold the funds until it was finally determined as to whether the taxpayers were entitled thereto and if it was so determined that they belonged to the taxpayers would at once pay them over to them. This would reimburse the taxpayers to the extent only of the principal of the sums paid them. They would still have to look to the warrants on the General Fund for the interest thereon. Section 10 respects this right and provides that the taxpayer recover interest on the tax paid by him from the date of its payment.

It is seriously urged that the taxpayer cannot refuse to pay the tax and submit to the drastic civil and criminal penalties in the Act.

The taxpayer can be subjected to but two proceedings, a civil and a criminal proceeding. And he can be readily relieved of these by complying with the statute and bringing an action to recover the tax which he has paid. In the case of *Allen* v. *Pullman Palace Car Company*, 139 U. S. 658 the court said:

> "So far as appeared, complainant could avert all the consequences which it deprecated as likely to ensue if the state officials were not restrained, by complying with the terms of the statute and availing itself of the remedy thereby afforded."

In the case of *Arkansas B. & L. Ass'n* v. *Madden*, 175 U. S. 269 in giving the reasons why the injunctive relief should be denied the court said, among other things, that the "bill sets up no special circumstances justifying the exercise of equity jurisdiction other than consequences which complainant can easily avert."

It may be that it is more convenient to try the question as to the legality of this suit in equity than at law, but that is not sufficient to justify this court in granting the injunctive relief sought. In the case of *Arkansas B. & L. Association* v. *Madden*, supra, it is said:

> "It is quite possible that in cases of this sort the validity of a law may be more conveniently tested by the party denying it by a bill in equity than by an action at law, but considerations of that character while they may explain, do not justify resort to that mode of proceeding."

By letter of recent date we are informed that appellants would rely on Chapter 20 of the Acts of the 1932 General Assembly, and upon Chapter 13 of the Acts of the 1926 General Assembly, and upon Chapter 122 of the Acts of the 1924 General Assembly, and upon *State Budget Commission* v. *Lebus*, 244 Ky. 700; *Rhea* v. *Newman*, 153 Ky. 604; and *Bosworth, Treasurer*, v. *Shuck*, 118 Ky. 458.

Chapter 20 of the Acts of 1932 purports to be an Act authorizing the funding of certain indebtedness, so called, of the Commonwealth of Kentucky, which is evidenced by outstanding State warrants, by the issuing of funding bonds and acknowledging and confirming the

validity of such warrants and the indebtedness evidenced thereby, but this Act was held to be unconstitutional in *State Budget Commission* v. *Lebus*, supra, and the warrants held not to be an indebtedness.

Chapter 13 of the Acts of 1926 purported to be an Act to provide for execution and sale of $4,000,000.00 of bonds of the Commonwealth for the purpose of paying outstanding warrants of the Commonwealth and the interest accrued thereon, but the issue was defeated at the polls.

Chapter 122 of the Acts of 1924 purported to be an Act to provide for the execution and sale of $75,000,000.00 of bonds of the Commonwealth for building roads but when submitted to the people they voted against the issue.

The case of *Bosworth, Treasurer*, v. *Shuck*, 118 Ky. 458, holds that where a claim against the State is payable only out of a specific appropriation which has been exhausted, courts can not by mandate require the Auditor to issue a warrant for the claim on the Treasurer to pay it, but as pointed out in the opinion of the lower Court under the general law of Kentucky when there are no funds in the Treasury to pay the warrant drawn by the Auditor, the Treasurer shall stamp the warrant "interest bearing" and it bears 5% interest and is payable when the fund is sufficient to redeem it. *Rhea, Treasurer*, v. *Newman*, 153 Ky. 604, is relied on by appellants and it will be urged that these warrants are required to be paid in the order of their issue but an examination of the opinion will show, as pointed out by the Court below, that this requirement is only to insure fair treatment among the holders of outstanding warrants. Clearly, as held by the Court below, by virtue of Section 10 of the Act, and a fair and reasonable construction thereof, these warrants would take precedence over the other outstanding warrants, because it represents new moneys paid into the Treasury from taxpayers coming within the provis-

ions of the Act, where such taxpayers have been adjudged recovery thereof.

The case of *State Burget Commission* v. *Lebus*, supra, will doubtless be relied on because to uphold the validity of this funding measure it was urged by the Budget Commission that without the issuance and sale of bonds, as provided for by that Act, the outstanding Auditor's warrants will depreciate in value, the credit of the State will be unduly affected, and the expenses of the State Government can not be defrayed. Sufficient answer to this language relied upon by appellants to show the remedy afforded by Section 10 is not plain, adequate and complete would seem to be that the Court refused to adopt this theory and held the warrants not to be a debt against the State, and the funding act invalid.

The outstanding State warrants in this period of depression have not depreciated in value to any greater extent than bonds of the United States Government. The warrants of the State heretofore drawn on the general fund are selling on the market at ninety-three to ninety-five cents on the dollar.

We do not know what contention with reference to the present market value of Kentucky State warrants will be made by appellants, since we have not received copy of their brief. We are, therefore, not in a position to answer any argument which they may advance, except what we have just stated.

B.

The State by Section 10 of the Challenged Act Waived its Immunity and Consented to be Sued in Both State and Federal Courts.

Section 10 of the challenged Act authorizes the aggrieved taxpayer to prosecute an action either in the State or Federal Courts for a recovery of the tax paid

under protest. The action which it authorizes to be brought against the Auditor of Public Accounts is one against the State of Kentucky. This question is settled by the following cases:

North Carolina v. Temple, 134 U. S. 32;
N. Y. Guarantee Co. v. Steele, 134 U. S. 230;
Highway Commission v. Utah Co., 278 U. S. 194.

It is true that a state cannot be sued without its consent and, this being so, it can limit its consent to being sued in its own courts. If it so does it can not be sued in the Federal court. But here the consent was not so limited. There is no possible ground for claiming that it was. The provision is that the taxpayer "may sue the Auditor of Public Accounts in an action at law to recover the tax so paid." There is no limitation placed upon the general language. In the case of *Singer Sewing Machine Co.* v. *Benedict*, 229 U. S. 481, the statute imposed the duty on the Board of County Commissioners to refund to the taxpayer an illegal tax which he had paid. This was the sole provision of the statute on the subject. It was held that this conferred on the taxpayer "a correlative right to enforce that duty by an action at law", and further, that:

> "This right was one which could be enforced by an action at law in the circuit court, no less than in the state courts, if the elements of Federal jurisdiction, such as diverse citizenship and the requisite amount in controversy, were present."

In each of the cases of *C. B. & Q. R. Co.* v. *Osborne*, 265 U. S. 14-16, and of *Risty* v. *Chicago R. I. & P. Ry. Co.*, 270 U. S. 378-388, the decision in this case was cited in support of the position that if an action to recover a tax is allowed generally, i. e., without limitation, it may

"be brought in the courts of the United States under the usual conditions as well as in those of the State."

The remedy provided by the Tennessee statute involved in the cases of *Shelton* v. *Platt*, 139 U. S. 591, and *Allen* v. *Pullman Palace Car Co.*, 139 U. S. 658, was an action against the officer collecting the tax to recover it and the provision was that if the court determined that it was wrongfully collected then upon its certificate to that effect the Comptroller should issue his warrant for same on the Treasurer. It was held that because of this remedy the injunctive relief should be denied. This could only have been on the ground that such action could be brought in the Federal court or that it was immaterial whether it could or not if the Supreme Court had appellate jurisdiction of an action brought in the State court. The opening provision of Section 10, to-wit: "No suit shall be maintained in any court to restrain or delay the collection or payment of the tax herein imposed upon any ground" makes certain that it was the intent of the Legislature to provide that the action which it authorized could be brought in the Federal courts of this State. There can be no question that the provision was directed to the bringing of such suit in Federal courts as well as the courts of the State. Its sweeping language requires this.

The other ground upon which appellants claim that the right of action conferred by the provision in question is confined to the State courts, to wit: that the relief which it authorizes is a writ of mandamus against the Auditor of Public Accounts and Federal courts have no jurisdiction of suits for mandamus is equally untenable. What it authorizes is the taxpayer may sue the Auditor of Public Accounts in an action at law to recover the tax which he has paid. This language means that he may sue such officer to recover a judgment against him for such tax so paid. It can mean nothing else. To the

same effect is the concluding sentence of the section which is in these words:

> "A separate suit need not be filed for each separate payment made by any taxpayer, but a recovery may be had in one suit for as many payments as may have been made and which are not barred by the limitation of two years herein imposed."

One can not be said to recover in a suit for a writ of mandamus. Nor can a recovery be said to be had in a suit of such a writ.

It is urged that this strained construction of Section 10 is required by Section 162 of the Kentucky Statutes in the light of which it should be construed. That section is in these words:

> "When it shall appear to the Auditor that money has been paid into the treasury for taxes where no such taxes were in fact due, he shall issue his warrant on the treasury for such money so improperly paid in behalf of the person who paid the same. Nothing herein contained shall authorize the issuing of any such warrant in favor of any person who may have made payment of the revenue tax due on any tract of land unless it is manifest that the whole of the tax due the Commonwealth on such land has been paid, independent of the mistaken payment and ought to be reimbused."

It is true that Section 10 should be construed in the light of Section 162. But the latter provision makes against and not in favor of such construction of Section 10. If the two are the same why the necessity of Section 10? But clearly on their face they are not the same. Section 162 makes no reference whatever to the bringing of any suit. All it calls for is an issuance by the Auditor of his warrant on the fact being made to appear that money has been paid into the treasury for taxes that

were not due. The right to sue for a mandamus to compel him to issue it if he refuses is not by virtue of any provision in the statute. It is because of a principle of the common law. Chapter 12 of Kentucky Civil Code of Practice regulates the procedure in such a case. Section 10 makes express provision for the bringing of an action. Section 162 provides a single step, to wit, the issuance of the warrant on the demand of the taxpayer. Section 10 provides for two steps, first an action at law to recover the tax and a recovery thereof in such action and then if the court determines that the tax has been wrongfully collected, i. e., adjudge a recovery thereof, the issuance of a warrant in satisfaction of such determination and judgment. Clearly the first step is not the same as the second. It is something different. It has no relation to a writ of mandamus. It is the second step which has such relation. The first step is and can be nothing else than a judgment for the recovery of the tax. The mandamus which is authorized is ancillary to jurisdiction already acquired by the action at law to recover the tax and the judgment thereon. It is in the nature of an execution to carry the judgment into effect. It is well settled that a Federal court has jurisdiction of such a mandamus.

Greene County v. Daniel, 102 U. S. 187;
Davenport v. Dodge County, 105 U. S. 237.

Referring again to the case of *Singer Sewing Machine Company* v. *Benedict* all that the statute provided was to impose on the board of county commissioners the duty of refunding to the taxpayer the illegal tax which he had paid and from the imposition of that duty the court implied that the statute conferred on the taxpayer a correlative right to sue not for a writ of mandamus, but to enforce that duty by an "action at law" which might be brought in the Federal court as well as the State

court. In the case of *Southern Ry. Co.* v. *Query*, 21 Fed. (2) 333, the South Carolina statute involved was, except in one particular, substantially the same as Section 10. That particular is that the right of action to recover the tax which it conferred was limited expressly to the "court of common pleas for any court having jurisdiction," whereas here there is no such limitation. This contrast between the two statutes evidences that the Legislature of Kentucky did not intend to limit the right of action which it conferred to the State courts. It was held that the right of action which in the State court it conferred was "to recover by an ordinary action at law." It never occurred to the court that the right of action which it so conferred was for a writ of mandamus.

In 25 C. J., p. 742, it is said:

> "The state having once consented to be sued, ancillary proceedings are within the Federal jurisdiction without further consent, unrestrained by the limitations of the Eleventh Amendment."

A similar rule was laid down by this Court in the case of *Gunter* v. *Atlantic Coast Line Railroad*, 200 U. S. 273.

By Section 10 the Legislature did something more than authorize the aggrieved taxpayer who has paid the tax under protest to file a suit in either the State or Federal court for the recovery of the tax so paid. The Legislature provided the aggrieved taxpayer, if successful in recovering a judgment for the tax, a specific and definite method of enforcing the judgment.

PART TWO

We shall, in this part of the brief, attempt to deal with the merits of the law under attack. We shall discuss under appropriate headings the questions which we deem important to a consideration of this phase of the case.

PASSAGE OF THE ACT

Every legislative act of any consequence must have its "ballyhoo" in order that a general interest may be aroused in its passage. An appeal was made to the small retailers of this State by certain individuals *wholly disassociated from the State Tax Commission, which sponsored the bill*, it being represented to them that this measure would impose no particular hardship upon them, and in a measure would serve to equalize the one-sided battle which they had been waging against their large chain store competitors, who by the legitimate practice of volume-buying, national advertising, and certain other features, later to be discussed, and the illegitimate practice of price-cutting for the purpose of throttling competition have threatened the very existence of small independent store ownership.

It is not, and can not be denied, that this legislative act had its inception in, was drawn by, and its passage was brought about by the State Tax Commission, unassisted and without the instigation of any individual or group. At the time of the passage of the act, certain small retail merchants undoubtedly favored its enactment, just as many of the large retailers and chain store owners opposed its passage by a powerful lobby. Such is true of every revenue act introduced, and this is necessarily so far the reason that when any tax measure is properly conceived, it must exact the greatest amount of tax from those most able to bear it and most able to wage

a vigorous fight against its passage. If it were not for the fact that this measure imposes no particular burden upon those whose earnings do not justify it, but rather upon those who are able to pay, and should pay, and are required to pay, the appellants would have very little to talk about. They, therefore, use this fact as a basis for charging class legislation, discrimination, oppression, confiscation, and have sought to paint a picture of impending communism.

Before undertaking a discussion of the evidence which has been introduced, we would call the attention of the Court to this fact. The test of whether this tax, or any tax, is confiscatory depends upon how it affects the group upon which it is imposed as a whole, rather than whether or not it happens to work a hardship upon a few isolated individuals, firms, or corporations, whose gross sales bear no proper relation to their net profits by reason of internal dissension, inefficient management, and attempts to throttle competition by price-cutting, or any similar system or practice.

It is significant that when a motion was made in the United States District Court in Louisville on the 28th day of March, 1931, that J. C. Penney Company, Stewart Dry Goods Company, Levy Brothers, and Kroger Grocery & Baking Company filed a verified list of those for whose benefit this action was brought, and who were silent partners to this litigation, a list of forty-seven of the largest business enterprises in the Commonwealth of Kentucky was produced and filed of record in this proceeding. It is reasonable, therefore, to suppose that of this large number, the four named appellants were chosen because of the fact that their net profits were far below what they should have been in proportion to their gross sales. This conclusion is arrived at when we take into consideration the situation of the Kroger Grocery &

Baking Company in particular, whose cries that the tax imposed upon it is confiscatory have rung the loudest. That company is not the largest retail grocery chain store company doing business in the State of Kentucky, but occupies second position to the Great Atlantic & Pacific Tea Company. From the fact that the Great Atlantic & Pacific Tea Company will be called upon to pay $15,000 to $20,000 more tax annually under this Act, we begin to wonder why, as the Company most affected, it has not actively participated in this litigation, but has left the burden of "carrying the ball" for the large chain store group to the Kroger Company. The answer is this: Lybrand, Ross Bros. & Montgomery, certified public accountants, are able to swear that they have completed and published their annual audit of the Kroger Company for the year 1930, which shows that the net earnings of that company were 81/100 cents on each dollar of gross sales for the year 1930, as against the average for the preceding six or seven years of considerably more than 2 cents and particularly for the year 1929, 2.07 cents.

The Great Atlantic & Pacific Tea Company, the "silent partner" in this litigation, closed its books for the year 1930 on February 28, 1931, reporting that it had 15,737 stores in operation, or a gain of 319 during the year. It likewise reported that for the year 1930, its stores turned in a volume of $1,065,806,000 gross sales, despite lower commodity prices. It likewise reported that *the increased volume of gross sales resulted in the margin of net profit being increased from 2-49/100 cents per dollar of sales in 1929 to 2-88/100 cents per dollar of gross sales in 1930.* The result was a net profit in 1930 of $30,000,000 as against $26,000,000 in 1929.

It may, therefore, safely be said that the position of the Kroger Company is hardly indicative of the general situation prevailing in the retail merchandising industry

as a whole, and this is made manifest by the charts which are filed by appellees as exhibits in these cases, and to which we shall specifically refer later on.

We call the Court's especial attention to what we have just said in order that this discussion may be approached with the full understanding, that the four merchandising enterprises which appear as appellants in this Court, and whose affidavits and exhibits appear in these cases, are hand picked out of a group of about fifty available, for the sole purpose of making the tax appear as rigorous as possible.

ANALYSIS OF APPELLEES' EVIDENCE

Whether or not this tax is violative of the Fourteenth Amendment of the Constitution of the United States and of Sections 171-181 of the Constitution of Kentucky is largely a matter of evidence, the rules of law enunciated in the decided cases being clearly defined and in the main possessed of little variation. It, therefore, seems well to enumerate and discuss in proper order the more important contentions which are advanced by the appellees in this proceeding, together with an analysis of the evidence introduced by way of substantiation.

I. THE RECENT SHIFT IN AMERICAN ECONOMIC LIFE AND CONSEQUENT INCREASED NEED FOR GOVERNMENT SERVICE

I. The general changes that have occurred in economic life in the course of the past several years, more particularly in the period since the World War, have been of such character as to necessitate increased activity on the part of the State. This has arisen in part because of changes in the organization of industry and trade, such as the shift toward corporation rather than partnership or individual business; partly from techni-

cal changes in production activities, such, for example as the development of the large use of highway transportation in business and industry; partly from the necessity of replacing services formerly provided by private initiation and now conducted by governmental authorities; and partly from other causes. These shifts to the modern way of carrying on social activities bring about the necessity of developing increased sources of state revenue, including especially heavier taxation of business enterprises. One large element in this change has been the shift in merchandising practice which has, in order to secure greater economic efficiency, resulted in requiring merchants of the new type to devote themselves more exclusively to business and hence has removed the possibility of their giving large effort to special activities on the one hand and on the other, has tended in the direction of increased non-resident ownership and management of retail stores with consequent instability of local managers' position, thus lessening the immediate interest of those in charge of *the store* in social activity. This has, of course, resulted in greater necessity of state activity to perform those duties formerly cared for by local initiative—individual or collective.

Analysis of the affidavits presented by appellants, if any evidence other than common observations were necessary, shows conclusively that large scale merchandising in Kentucky is carried on very largely by chain stores, department stores and departmentized stores of other classes. A study of the evidence presented by Professor Burr (Kroger record, p. 368) makes it clear that there is a distinct shift toward multiple-store merchandising (one form of large-scale merchandising), and he shows that this shift is taking place in such a way that more and more of the retailing in the United States is in the hands of multiple-unit stores. This is likewise emphasized in the affidavits of Robert W. Lyon and John B. Bonham,

presented by appellants (Kroger record, pp. 104-128), and also the evidence of Professor Nystrom (Kroger record, pp. 278-290). It may be set forth more explicitly perhaps by reference to the indexes prepared by the Federal Reserve Board and presented monthly in the *Federal Reserve Bulletin* (also quoted in Professor Paul H. Nystrom's *Chain Stores*, p. 31). This statement of the situation really takes only partial account of growth because it does not systematically include new chain organizations that are established from time to time but shows only the increase in volume of business conducted by those already in existence. It indicates that between 1919 and 1929 the chain grocery business increased more than 422 per cent. The 5 and 10 cent store business, the wearing apparel business, the drug store business, the shoe business, cigar business and the candy business, are shown to have increased greatly though in each instance somewhat less than the increase that occurred in the grocery business. In no case did the amount of chain store business actually carried on in these older merchandising plants fail to increase 200 or 300 per cent, except in the cigar and shoe business which had already grown to remarkable proportions, in the case of the relatively small number of merchants included, prior to 1919.

In the few instances in which data are available for earlier years (U. S. Department of Commerce, *Survey of Current Business*, August 1930, p. 119) the statistics indicate clearly that the growth has been exceedingly rapid since 1913.

As brought out in the testimony of Mr. Lyons and Mr. Bonham (Kroger record, pp. 104-128) it is entirely clear that this means a considerable shift in the method of carrying on the retail business of American communities. This is an obvious verification of the contention of appellees (*Kroger Answer, Kroger record* p. 63) that the chain-store method of doing business is in a consider-

able measure replacing older methods. This is likewise made obvious in the testimony of Dr. Walter Burr of the University of Missouri in his direct examination at pages 369 to 370 (*Kroger record*) of his deposition.

In view of the tendency—observed by all students of merchandising and of economic life in general—to replace the old style independent merchant with the large-scale department store or departmentized unit store or with the multiple-unit store (all of which classes often involve absentee ownership usually through the corporate form of organization thus separating the actual managers of the stores from an ultimate management), it is important to inquire how local social functions are to be carried on efficiently. In other words, making it essential that local employees give their time exclusively to the store and consequently impossible for them to perform community services formerly rendered by the old-style independent merchant raises the issue as to how society shall see that the functions are performed. Coupled with this development there has, of course, been a considerable saving of money, both to the consumer (at least directly) and more especially to the merchant (*Affidavit of James W. Martin, Kroger record*, pp. 329-333). Thus the large-scale retailer has much greater relative ability to support social activities than have the surviving independent, small-scale retailers.

This shift clearly must involve numerous incidental results as to the method by which community life is conducted in actual practice now that the element of voluntary service to the community rendered by local retailers—and, for that matter, by the local citizen—has considerably declined, though the need in this matter has remarkably increased. In actual fact, the state itself is undertaking much of the work. This appears to be almost inevitable, and it is perhaps most obvious in those lines of activity in which the immediate welfare of the

population is directly involved—that is, in those spheres where voluntary contributions of time and money bulked largest. For example, expenditures by cities in the United States for charities, hospitals, and corrections increased between 1919 and 1927 from $53,000,000 to $100,000,000 in round figures. Expenditures for recreation increased from $24,000,000 to $54,000,000 and expenditures for health and sanitation from $76,000,000 to $160,000,000. Various miscellaneous items increased from $34,000,000 to $78,000,000, (U. S. Department of Commerce, *Financial Statistics of Cities*, 1927, p. 49). Similar increases have been taking place in state expenditures as shown by the growth in payments for these same items by state governments in the same period from $134,000,000 to $193,000,000; from $1,000,000 to $4,000,000; from $14,000,000 to $28,000,000; and from $36,000,000 to $49,000,000 respectively (U. S. Department of Commerce, *Financial Statistics of States*, 1927, p. 26). Thus it may be seen that the movement is national in scope.

That it is equally clear-cut in Kentucky—though somewhat more concentrated—may be seen from the following tabular presentation of Kentucky data for the State and for cities as reported by the U. S. Department of Commerce.

GOVERNMENTAL COST-PAYMENTS BY KENTUCKY AND CITIES THEREIN FOR SPECIFIED OBJECTS IN 1927 AS COMPARED WITH 1919

(Round numbers)

Year	Charities, Hospitals and Corrections	Recreation, Etc.	Conservation of Health	Miscellaneous
State				
1919a	$2,100,000	$5,000	$85,000	$26,000
1927b	2,500,000	35,000	89,000	310,000
City-c				
1919d	459,000	136,000	156,000	2,000
1927e	848,000	188,000	525,000	259,000

a. *Financial Statistics of States*, 1919, Table 10.
b. *Financial Statistics of States*, 1927, Table 12.
c. Include Lexington and Louisville. No others are reported in detail for both years.
d. *Financial Statistics of Cities*, 1919, Table 11.
e. *Financial Statistics of Cities*, 1927, Table 12.

It appears, then, that the shift which has been taking place in the general economic organization of society, including especially retailing, has meant that society as such is called upon to shoulder numerous burdens hitherto carried on by voluntary activity—either cooperative or individual. No allegaiton is made as to whether that is desirable or undesirable. It is simply a fact that must be faced, and facing it means facing the necessity for providing state and local revenue to meet the exigencies of the situation.

Thus far the increased burden of resulting taxation has been borne in very large part—so far as retail merchandising is concerned—by the relatively smaller stores because the state has in the main employed the property tax as a means of raising the necessary revenues. This has of necessity resulted (*Affidavit of James W. Martin. Kroger record*, pp. 333-338) in throwing the burden on the small merchant rather than on the large one. This fact is made clear by exhibits submitted by the defense,

which show that to say there are simply two classes of retailers, large and small, is to misinterpret the exhibits which show unquestionably that there is a clear-cut tendency under the present tax system to impose a lower and lower rate on larger and larger merchants. In other words, the tendency extends from the very smallest scale of retailing to the billion-dollar-a-year retailer such as the Great Atlantic and Pacific Tea Company. There are, of course, slight variations, but there is not the least question but that the general tendency is apparent at all stages where there is a sufficient number of merchants to justify any statistical comparison. These facts necessitate, if the tax system is to result in fairness as between different taxpayers, that it shall be adjusted by arising a larger percentage of total revenue through the imposition of business taxes and through making those taxes definitely progressive; that is, making them levy a *higher rate* on the larger than on the smaller businesses. This is already done in a number of states, for example, Maine (*Affidavit of Henry F. Walradt*, pp. 305-311, *Kroger record*), Wisconsin (*ibid.* p. 6), West Virginia (*Gross Sales Tax Act*, 1925), and in Georgia (*Gross Sales Tax Act*, 1929).

The Gross Sales Tax Act in Kentucky provides a different scheme of graduation from that in these other states; but, if section 4 of the Kentucky Act be interpreted as a repeal of the numerous individual license taxes hitherto imposed except for the purpose of providing minimums, there is no instance at any point under the Kentucky Act of as steeply graduated rates as are to be found in the statutes of some of the other states. For example, under the 1881 Maine law (sustained and digested in *Maine* v. *Grand Trunk Railroad Company of Canada*, 142 U. S. 217), the tax on a railroad corporation having receipts per mile of $2,250.00 was 0.25 per cent of total receipts; whereas the railroad company which

had $2,250.01 a mile paid at the rate of 0.50 per cent on its gross receipts. Or, under the West Virginia gross sales tax act of 1925 there was provided a complete exemption of all receipts up to $10,000; thus the tax rate on the concern having gross receipts of $10,000.50 is *infinitely higher* than the rate on the business having gross receipts of $9,999.50.

The conclusion from this discussion, of course, is not that the several other states referred to have unreasonable graduation but that it is necessary for the legislature to exercise discretion in determining the rates and particularly in setting the bases and brackets for purposes of graduation.

The whole matter may be resolved into the simple statement that current tendencies in economic development—at least in retailing—make it necessary for the state to undertake functions which in a ruder civilization were performed by individuals—in concert or separately—on a voluntary basis and that the state must raise revenues to make possible the performance of these functions. Hitherto this increased tax levy has been imposed, so far as retailers are concerned, on relatively small-scale business because of the economic conditions prevailing—more especially because the small operator does not enjoy such rapid turnover and consequently is subjected to a heavier property tax, but particularly also because the large property is in general not assessed at as near 100 per cent of its market value as are the smaller-sized parcels of property. (The evidence on this point has been summarized in a recent study published by the Bureau of Business Research of the University of Iowa. *Assessment of Real Estate in Iowa and other Mid-western States*, and *Technical Bulletin* 172 published by the U. S. Department of Agriculture.) It is consequently necessary, in order to secure a semblance of equality, to offset the heavier effective rates of property taxes on

small merchants by a rate schedule of business taxes so drawn that the larger merchant will pay *higher rates* than the smaller merchant. Otherwise the total tax rate grossly discriminates in favor of the large-scale enterprise.

II. RATE STRUCTURE PROVIDED IN THE GROSS SALES TAX STATUTE

1. Precedents for the Kentucky Gross Sales Tax

Considerably over 2,000 years ago the Greeks used a gross sales tax providing rates of 1 per cent on sales of commodities. This applied both to imports into the city and to goods produced and sold in the city. At various times the rates varied, and sometimes there were different rates for different commodities. (Gilbert, *Greek Constitutional Antiquities*, p. 334 ff.)

At the present time Bolivia has a sales tax (*Sales Tax Act of January 23, 1918*) providing for rates of 0.5 per cent which exempts products taxed under other sales taxes provided in the law of Bolivia. It likewise exempts those having less than approximately $365 invested in business, thus introducing an element of graduation.

Even in the United States there are fairly numerous sales taxes, some of them general and some of them selective. Some apply to commodities of all or practically all classes (for example, the Pennsylvania Merchants' License, the Virginia Merchants' License Tax, the West Virginia, the Georgia, and the Mississippi Gross Sales Tax Acts); others apply only to commodities or services of specified classes. (For instance Ohio, Maine, and other public utilities taxes. See *Affidavit of Walradt, Kroger record*, pp. 305–307.)

The evidence which the appellees have submitted with respect to these several precedents has been attacked by appellants, but counsel have failed miserably in attempting to offset the effectiveness of the affidavit

of Dr. Walradt. For example, appellants remarks with respect to the French Sales Tax do not in the least invalidate the point that here is a great country imposing a tax of twice the highest possible rate under the Kentucky law without having confiscated or affected the business of French retailers. The innuendoes respecting Russia—and apparently designed to appeal to *presumed Anti-Soviet prejudice*—fall so flat as to merit no comment. According to Dr. Shoup of Columbia University, who is the leading American authority on the subject, there is no indication that France will soon abandon the 2 per cent sales tax now levied (Shoup, *The Sales Tax in France*, p. 353). Appellees have also shown (*Affidavit of Walradt, Kroger record*, pp. 307–308) that for fifty years the State of Maine has levied a *graduated* gross sales tax on specified classes of public utilities. That, contrary to appellees contention, the Maine statute provides a graduated rather than a proportional rate is conclusively shown by the following quotation from the act itself.

> "The amount of the gross transportation receipts as returned to the Public Utilities Commission for the year ended on the thirty-first day of December preceding the levying of such tax shall be compared with the net railway operating income for that year as returned to the Public Utilities Commission; when the net railway operating income does not exceed ten per cent of the gross transportation receipts the tax shall be an amount equal to three and one-half per cent of such gross transportation receipts; when the net railway operating income exceeds ten per cent of the gross transportation receipts, but does not exceed fifteen per cent, the tax shall be an amount equal to four per cent of the gross transportation receipts; when the net railway operating income exceeds fifteen per cent of the gross transportation receipts, but does not exceed twenty per cent, the tax shall be an amount equal

to four and one-half per cent of such gross transportation receipts; when the net railway operating income exceeds twenty per cent of the gross transportation receipts but does not exceed twenty-five per cent, the tax shall be an amount equal to five per cent of such gross transportation receipts; when the net railway operating income exceeds twenty-five per cent of the gross transportation receipts, the tax shall be an amount equal to five and one-half per cent of such gross transportation receipts; provided, however, that in the case of railroads operating not over fifty miles of road, the tax shall not exceed two per cent of the gross transportation receipts; and provided further that when the net railway operating income of any narrow gauge railway located wholly in this state exceeds five per cent but does not exceed ten per cent of its gross transportation receipts, the tax on such railroad shall be one-half of one per cent of its gross transportation receipts; and when the net railway operating income of such railroads exceeds ten per cent of its gross transportation receipts, the tax shall be one per cent of its gross transportation receipts; and when the net railway operating income of such a railroad does not not exceed five per cent of its gross transportation receipts, no excise tax shall be assessed upon it." (*Revised Statutes of Maine, 1930*, p. 238.)

Moreover, the Maine laws of 1881 and 1907, imposing progressive gross receipts taxes graduated without any reference *to net income or net earnings*, are completely ignored in appellants' discussion although upheld by the Supreme Court of the United States. The point is entirely clear that for thirty or forty years the State of Maine has imposed a graduated gross receipts (or gross sales) tax with maximum rates of thirteen times the lowest rate and that this statute was sustained by the Supreme Court of the United States (*Maine v. the Grand Trunk Railway, supra*).

The quibbling of appellants over Dr. Walradt's use

of the terms gross earnings, gross receipts, and gross income as synonymous with gross sales will, of course, have no tendency to confuse the court. As a matter of fact, the business of the Kroger Company is such that gross sales and gross receipts are practically identical. By a simple change in accounting practice—sometimes without any change—the retailer can, and doubtless will, show gross sales as the same as net sales. Under the law of Ohio also it is obvious that gross receipts, gross earnings, and gross sales mean the same thing, for the law provides that "such statements which also contain the entire gross earnings *including all sums earned or charged, whether received or not.*" (Sec. 5472–5474.) In general, therefore, it may be said that gross earnings, gross sales, gross receipts and net sales are for all practical purposes synonymous as implied in Dr. Walradt's discussion of the subject. (*Kroger record*, p. 307.)

2. The Relation of the Gross Sales Tax Act to Other License Taxes

Section 4 of the Kentucky Gross Sales Tax Act provides that:

> "Should any retail merchant, as defined herein, be liable for and pay any special state license, excise, occupational or corporation license tax under the law now in force, or that may hereafter be enacted, credit may be taken on the tax levied in this act for the amount of such special license, excise, occupational or corporation license tax so paid not to exceed the amount of the license or excise tax levied herein."

It is apparent from this provision that the Legislature sought to replace the numerous State excises on different types of retail business and portions thereof by one systematic license or excise tax, namely the gross sales tax. Consequently the statute by this credit pro-

vision simply retains the older licenses as minimum taxes on retail businesses and superimposes the gross sales tax in such a manner as to provide a systematic, graduated tax scheme for retailers. This is essentially what is done by the Virginia Merchants' License (*Tax Code of Virginia*, 1928, sec. 188), except that the Virginia Act provides a minimum and graduates the rate on larger enterprises, whereas the Kentucky statutes provides—by section 4, credits—i. e.—minimum rates for merchants and—by the scale of rates in section 2—specifies a scheme of graduation such that larger merchants pay a higher rate than smaller ones. In other words, the only element of the pre-existing license taxes retained by the 1930 statute is a series of minimums for different classes of retail merchants.

Appellants appear to be unable to distinguish between "credits" and "exemptions."

Section 4 does not provide for exemptions. *Retail merchants having the same volume of gross sales are subject to the same tax. The tax applies to all.* Section 4, however, provides that credit against this tax will be allowed to all merchants who have paid certain specified taxes for the amount of such taxes. This credit is open *to all* who have made such payments. If any merchant fails to receive any credit it is because he has not made any such payment. He does not have any higher gross sales tax imposed upon him than another merchant making the same amount of sales, but who has paid one or more of the specified taxes for which credit is allowed. He pays only the one tax—merchants receiving credit against their sales tax pay other taxes as well as the sales tax. In order not to have the total tax burden mount too heavily the law provides for the offset of these taxes against the sales tax. This works no hardship on the merchant who receives no credit since he has not paid the other taxes.

It should be noted that the credit is taken against the gross sales tax as computed and not against the gross sales before the tax is computed. The latter method would result in actually causing merchants having the same sales volume to be subject to different rates of the sales tax. The method provided by the law, however, results in all merchants having the same gross sales being subjected to the same rate of gross sales tax. Then in the case of mechants who have already paid certain taxes relief from the double burden is provided by means of the credit. Size has nothing to do with this credit. All merchants, large or small, who pay such taxes are allowed the credit.

The confusion of appellants respecting Section 4 seems to arise from lack of familiarity with tax terminology. They fail to differentiate between providing that one tax shall be in lieu of or a substitute for another tax and providing that one tax may be credited against another. For example, suppose that a given concern pays during a year $1,000 for license and other taxes mentioned in this section and that its gross sales tax amounts to $1,500. If the license and other taxes were in lieu of the gross sales tax, this concern would pay only $1,000; but if these taxes are credited against the sales tax, the concern will pay $1,500 consisting of the $1,000, for the license and other taxes plus $500, the amount by which the gross sales tax exceeds the credit allowed for license and the other specified taxes which this concern pays.

There is nothing discriminatory in permitting these credits since all retail merchants, whether large or small, are granted the same privilege. The one case in which on first thought there might seem to be discrimination is the credit allowed for corporation license tax. The appellants emphasize this, contending that individual merchants and partnerships are discriminated against since they cannot take advantage of this credit. Upon

second thought however it is clear that the act merely removes a discrimination which the state had been previously making against the corporations in favor of individuals and partnerships. Merchants who incorporated were called upon to pay a corporation license tax which individuals and partnerships engaged in retail merchandising did not pay. The State is under no compulsion to levy a corporation license tax and is, of course, free to reduce such a tax or repeal it altogether if it so desires. The Legislature in passing the Gross Sales Tax Law which applies to all merchants regardless of the form of business organization, apparently believed that since the incorporated merchants were already paying a license tax it would be imposing too heavy a burden upon them if they were required to continue to pay the full amount of the corporate license tax plus the new license tax in the form of a tax on gross sales. In justice to the incorporated merchants, therefore, and not to discriminate against the partnerships and individual merchants, the Act provides that any corporation license tax paid by a retail merchant may be credited against the Gross Sales Tax. What then at first appears to be unjust discrimination against individuals and partnerships engaged in retail trade turns out to be a move to prevent an unfair burden being placed upon the incorporated merchant.

In the light of all these facts, it is easy to see why defendants' witnesses (*Affidavit of Walradt, Martin and Phelps,* Kroger record, pp. 309-312, 333-335 and 359-360. See also *Walradt,* Exhibits A, C-J, pp. 312a, 313-317, 324c, and Martin, Exhibits 12-16, pp. 346a-353, prepared by Drs. Martin and Phelps and made a part of their affidavits) dealt with gross taxes—that is with the scale of rates prescribed by the Gross Sales Tax Act, and really comparable for concerns of different size, except as specifically noted.

If the interpretation outlined be accepted (and the

section itself says it must be) it will be observed that, contrary to the contention of appellants that competitors of department and chain stores pay no tax, every retailer actually pays some tax as provided either in this statute directly or indirectly by reference in section 4. The actual effect of this Act is to substitute one tax for many, the pre-existing numerous licenses, by means of section 4, credits being retained as minimum payments. It will be seen too that *identical minimums* are allowed for all taxpayers, *large and small*, handling the same type of goods in the same circumstances, irrespective of the amount of sales. That the State of Kentucky may provide such minimum taxes there is no question whatever.

The effect of the allowed minimums provided by section 4 is well illustrated by the analysis presented by Mr. Martin and Mr. Brendel (*Kroger record*, pp. 100-102). This table is particularly interesting in that it shows that the credits allowed against the tax apply to concerns doing a large business as well as to those doing a small business. If the percentage of those filing reports in each of the classes listed in the table, which indicated no net tax, be computed, the result is as follows:

Showing retail sales less than $400,000	32.5%
Showing retail sales between $400,000 and $500,000	33.3%
Showing retail sales between 500,000 and 600,000	50.0%
Showing retail sales between 600,000 and 700,000	25.0%
Showing retail sales between 700,000 and 800,000	50.0%
Showing retail sales between 800,000 and 900,000	100.0%
Showing retail sales between 900,000 and 1,000,000	No report
Showing retail sales in excess of $1,000,000	100.0%

The table shows that nine out of the twenty-one concerns reporting sales of over $400,000, or 42.8 per cent of the number reporting, had credits enough to offset the tax. This is a larger proportion than the 32.5 per cent shown for those concerns whose gross sales are less than $400,000. Six out of the twelve concerns reporting sales of over $500,000, or 50 per cent of the number reporting, had credits enough to offset the tax. The only concern

reporting sales of over $1,000,000 and subject to the highest rates of the sales tax had sufficient credit to offset the tax.

The selection of *merchants* rather than stores for taxation under this act is vigorously attacked by appellants in that they alleged unfair discrimination because unit stores in competition with Kroger stores pay less tax than is charged against the Kroger store—assuming an allocation to individual stores of the total tax paid by the Kroger Company. The appellees contend that the statute properly provides that the unit of comparison is the *concern*—which may be operating one small store, one large store, a small number of small or large stores, or may be operating a large number of either small or large stores. When a store is only one of a number of stores operated by one concern, it ceases to be an independent unit and becomes a part of an operating whole. In attempting to establish an equitable tax system the aim should be to distribute the entire tax burden equitably between the various concerns.

The appellees have shown that as a rule the larger the amount of business which is carried on by a concern, the greater its ability to pay taxes. The only way to compare the amount of business done by different concerns is to take the aggregate of all of the business enjoyed by each concern regardless of whether it operates one department or many departments, one store or many stores. The operation of this principle is seen in the case of the Federal Income and the New York State Income Taxes and in most general business taxes. An individual merchant may own several stores or be operating several departments in one store. He does not compute the taxable income for each store or department and pay an income on each of those amounts. On the contrary he must compute the total taxable income received from all the stores or departments which he owns and the tax

will be placed upon the aggregate. It is upon this principle that the Kentucky Sales Tax is based, and appellants have in no way disproved the justice of this principle when they show that some Kroger units, assuming the tax to be split up among its various units on the basis of volume of business done, would pay a larger sales tax than another single independent store doing the same amount of business. In other words, as appellants agree, "The act itself makes no differentiation between individual merchants owning one store . . . and so called chain stores . . . " *There is no discrimination whatever against chain merchants.*

This insistance that the concerns, when subjected to a business tax, should be taxed as a whole rather than by a tax on its separate units is in accord with the general practice in other fields. If there is any occasion to enter the courts, either as plaintiff or defendant, it is the Kroger Company, and not one of its local stores which is the litigant. Central buying and management exists; and whenever profits are to be distributed, each separate unit does not send out dividends to its separate stockholders, but the Kroger Company distributes the dividends. Some individual units may have operated at a considerable loss and other may have been very profitable, but it is the aggregate of the gains and losses which determines whether or not dividends can continue to be paid. So it is the aggregate volume of business carried on by the Kroger Company in Kentucky which determines the amount of the tax due under the Kentucky Gross Sales Tax Law.

The assertion of appellants that "This is in addition to all other taxes paid by Kroger and Kroger taxes will be more than $500 per store," when taken in comparison with "together with all license fees and other taxes in addition thereto," seems to involve some confusion. In arriving at the figure $500 per store, it is evident from

the quotation that license fees have been added to the gross sales tax, and "all other taxes" would seem to include corporation tax and property tax as well. On the other hand, the statement is made by the appellants that "on a per-store basis this (that is $500) is 400 to 500 times the tax levied on competitors with the same volume of sales per store." In other words, this asserts that such competing stores pay only $1.00 to $1.25 in taxes. Obviously this *does not* include license or property taxes and apparently refers to gross sales tax only. Such a comparison is clearly ridiculous.

Moreover instead of adding the license fees and corporation tax to the gross sales tax in computing the total tax per store these payments should be substracted, as provided in section 4 of the Act. This, of course, is another error which would be misleading but for its transparency.

In the light of all this discussion, it is entirely clear that appellants are distinctly in error in saying "the record also shows that there are only a handful of retail merchants in the whole state of Kentucky outside of Class I, and that by reason of the exemption practically everybody in Class I is . . . tax exempt." (Argument in court below.) (1) The table submitted by witness for appellants (*Affidavits of Martin and Brendel*, pp. 100–102) shows clearly that over two-thirds of those in Class I (that is, having sales of $400,000 or less) show net tax liability. This does not at all bear out the statement (even ignoring the fact that in essence the Section 4 offsets are simply minimum rates) that practically everyone in Class I is exempt. (2) These tables also show that the credits—not exemptions—allowed in Class I constitute less than 50 per cent of the gross tax—another evidence that by no means everyone in Class I is exempt. (3) Moreover, it appears from the table itself that those reporting sales of $400,000 and

over get at least as much advantage in the way of Section 4 credits as to those reporting less than $400,000. (4) It must be emphasized repeatedly that the Section 4 credits really do not mean tax exemption but merely provide minimum rates due under this act.

The appellants contend (argument in court below) that "section 4 affords a complete demonstration of legislative intent to discriminate in favor of the retail merchants having a small volume of sales and against retail merchants having a large volume of sales." "Its practical effect," they claim, "is a *complete exemption* of practically all the smaller merchants from the exactions imposed by this Act." (1) A study of this section fails to disclose any such legislative intent as portrayed by the appellants. The credit provided for by this section is open to any retail merchant, *whether his volume of sales is large or small,* who pays any special state license, excise, occupational, or corporation license tax. (2) The evidence presented by Martin and Brendel (*Kroger record,* pages 100 to 102) indicates clearly that the larger concerns benefit from the credit granted by section 4 fully as much as the smaller concerns. This evidence shows that *over two-thirds* of the merchants filing reports showing retail sales less than $400,000 pay a net tax under this gross sales tax law. It is difficult to see that its practical effect is a complete exemption of *practically all the smaller merchants* from the exactions imposed by this Act.

3. Character of Graduation Provided

The general scheme of graduation of rates provided in section 2 of the act under attack is distinctly usual in the construction of rates structure. It is a well accepted principle of taxation that those having more income are able to pay a higher rate of tax than those having less; hence graduation of rates. As shown particu-

larly in appellees' exhibits (*Walradt*, Exhibit C and D; *Kroger record*, pp. 313-318a) the tax rate provided in the Kentucky Act increases *very gradually* with sales volume until those having sales of several millions of dollars approach, but never reach, 1 per cent. For example, the gross rate at $12,000,000 is shown .94208 per cent, and no matter how much the sales increase the gross tax never reaches 1 per cent of sales. As shown above *gross tax* is more significant for analytical purposes than *net tax* because the Section 4 credits are to be regarded as minimum rates and not as a reduction of tax liability, as explicitly set out in the beginning of the section.

That the statute provides not eight arbitrary classes for tax purposes, erratically established, but specifies an infinitely large number of graduated rates is likewise clearly shown in Dr. Waldradt's analysis (*Waldradt*, Exhibit C, *Kroger record*, pp. 313-317). If increases in gross sales by $100,000 brackets be observed, the graduation rates is gently upward, the maximum jump taking place between $1,000,000 and $1,100,000 of gross sales and amounting to only .0632 per cent. Even this largest increase of all is really almost an infinitely small quantity. This is an entirely sufficient refutation of the argument of appellants that the Act prescribes eight arbitrarily selected classes for rate purposes. Appellants object that the rates are not proportional to gross sales, but they cite nothing in the Constitution of the United States or of Kentucky prohibiting a graduated gross sales tax. It is, of course, well established that the Legislature may adopt any reasonable rate structure in the absence of constitutional prohibition.

The element of arbitrariness repeatedly complained of in the construction of the schedule of rates is equally applicable to all graduated taxes. Why, for example, should the Federal sur-taxes begin to apply to income in excess of $10,000, so that less than 1,000,000 of the

45,000,000 income receivers in the United States pay taxes under the provision? Why should the exemption from the Kentucky inheritance tax for widows be $20,000 rather $10,000 or $30,000? All these amounts, as well as the brackets provided, are arbitrary in one sense—the same sense in which the graduation under the Sales Tax is arbitrary. *Cooley on Taxation*, 4th Ed., p. 716, gives a clear statement of the law on this point:

> "A classification having some reasonable basis is not invalid merely because it is not made with mathematical nicety, nor because in practice it results in some inequality."

The appellees have shown (*Waldradt*—Exhibit C-J; *Kroger record*, pp. 313-317 and 324c) that the progression of the effective rates of the tax is gradual and that the highest possible rate falls below 1 per cent of gross. Even a 1 per cent tax on the volume of business is low as compared with similar taxes imposed elsewhere, illustrations of which fact have been presented. The rates do not run as high as did the rates of the 1918 Federal Income Tax Law. All this evidence points to the fact that the lines or points upon which the Kentucky Legislature determined are *not* "very wide of any reasonable mark" and that therefore, "the decision of the legislature must be accepted" as Mr. Justice Holmes has said. (*Louisville Gas and Electric Company* v. *Coleman*, 277 U. S. 32.)

In discussing this alleged arbitrariness appellants have repeatedly erred with respect to rate comparisons. The J. C. Penney Company, Levy Brothers and the Stewart Dry Goods Company are not taxed at a minimum of twenty times as high as the rates levied upon their competitors with larger sales per store (*Kroger record*, p. 328). The net tax on these businesses is respectively .54 per cent, .43 per cent and .74 per cent or

the gross tax is approximately .63 per cent, .43 per cent and .78 per cent respectively. The minimum tax on competitors is at least .05 per cent; and, in most instances, the effective (license and gross sales tax) rate is really greater than this figure. It could in no case be less, as the license tax credits are not to be regarded as exemptions in any sense.

Appellants have attempted at several points to demonstrate that the rates increase rapidly by comparing the successive rates applicable to one bracket *only* with the rate of 1/20 of one per cent which applies to the first bracket. Such a comparison is misleading. The only way to see the correct picture of how rapidly the tax increases as gross sales increase is to compute the effective rate applicable to the entire gross sales which are being taxed. This is shown in Walradt—Exhibit C. (*Kroger record*, pp. 313-317). From this table it is very clear that the increase in the rate of the tax as gross sales increase is gradual, that it does not mount in geometrical proportion, and that the largest increase in the rate of the tax for one class over the preceding class is only .0632 per cent (*Kroger record*, pp. 309-310 and 328).

Appellants' discussion of the size of the steps in the graduation of the instant tax is interestingly vacuous in the light of the gross sales tax in West Virginia where the rate on natural gas is zero if the amount produced is worth $9,999 annually but becomes 1.85 per cent on amounts in excess of $10,000 (*West Virginia Gross Sales License Tax*, Act of July 1, 1925); or in the light of the Georgia Gross Receipts Tax Law (an act approved Aug. 29, 1929) where the rate on merchants jumps from zero to 0.3 per cent below and above $30,000 respectively.

It may be logically concluded, therefore, that the Gross Sales Tax Act conforms admirably to the specifications laid down by appellants when they alleged "that

the power of the State to classify for purposes of taxation is of wide range and flexibility, providing, however, that the classification must be reasonable, and not arbitrary, and must rest upon some ground of difference having a fair and substantial relation to the object of the legislation, so that all persons similarly circumstanced shall be treated alike." (1) The classification is reasonable. As shown in Walradt—Exhibit C, (*Kroger record*, pp. 313-317) the increases in the effective rate from one $100,000 class to another are small, the largest being only .0632 per cent. (2) It rests upon the increase in the ability of concerns to pay higher rates as their business increases. This rule is generally sound, (*Kroger record*, pp. 306-307, 329-333, and 355-359), and the fact that illustrations in which large concerns have less taxpaying ability than small ones can occasionally be found, by no means nullifies the general rule. Thus the ground of this differentiation is fair and has a substantial relation to the object of legislation. (3) It treats all concerns similarly circumstanced alike in that all having the same gross sales and otherwise similarly situated, must pay the same tax.

4. Failure of Appellants' Subterfuges

One of the interesting subterfuges adopted by the appellants is that already referred to of confusing the issue by criticising the terminology of appellees, witnesses. This is more fully discussed in another section of this brief.

A second subterfuge, equally transparent, is illustrated from Mr. Bonham's testimony (*Kroger record*, p. 127).

> "It is *only because* we own a number of stores and the requirement that each store shall pay a tax return, based not on the sales of that store but on the sales of all other stores aggregate, that our tax

amount to $430 per store. In practical effect the law operates to prevent Kroger from operating a number of stores, *solely because of their number.*"

This is clearly an incorrect interpretation of the act. The tax is not imposed on the number of stores at all but on the volume of sales made by each concern. Kroger's tax would be just as heavy if it were conducted entirely under one roof and did the same volume of business. This tax progresses with the amount of business—not for the purpose of cutting down on the number of stores or departments operating but on the principle that the larger the volume of business done by a concern the greater its ability to pay taxes. This is true regardless of the reasons motivating a defense of, or opposition to, the Act when it was being considered by the Legislature.

The appellants have set up a number of other alleged instances of discrimination such as citing the case of Richman Brothers in competition with Levy Brothers where, as they allege, the discrimination arises "because they (Richman) have only one store in Kentucky;" whereas in actual fact the difference is due to the fact that Levy Brothers have large and Richman Brothers small sales in this Commonwealth. The same inaccuracy is found in the affidavit of Dann C. Byck (*Kroger record*, pp. 259-261) to the effect that differences in rate arise "merely because we operate a store selling a great many different items in a different city." Clearly this is not the real reason for the difference in reductions. If the total sales of Byck Brothers were either all in Louisville or all in Lexington the tax would be the same. It is not the fact that they are selling merchandise in two different cities or stores but that the total sales of the concern amount to what they do that determine the tax.

In general it appears that confusion of appellants' counsel is typified by the statement in the court below

that "the verified (!) reply denies that the tax in question levies a graduated tax upon the sale of goods at retail in the State of Kentucky;" while definitely asserting the proposition denied in the following words 'the rate of tax fixed by the Act is not proportional, but . . . *progressively* increases with *increased gross sales* in the following manner:" (stating the rates).

The summit of ridiculous presumption and naivete is attained in appellants' argument that increasing the volume of sales results from the altruistic wish to benefiting consumers. Do appellants really believe that retail merchants in general increase the volume of their sales and content themselves with a small margin of profit or even sell at a loss *in order to pass on to the buying public the benefits* of their efficient conduct of their business? Whom do you think is so witless as to believe this? *The reason and the only reason for retail merchants striving to increase the volume of their sales is to increase their net income. If their net income increases, their ability to pay taxes increases progressively, and it is this fact that the Gross Sales Tax recognizes in Sections 1 and 2, which provide progressive rates as the total gross sales of a concern increase.* Thus the implication of the appellants that these two sections were intended to unfairly discriminate against retail merchants having a large volume of business does not hold.

As a matter of fact, the tax herein imposed is not *proportional* but *graduated;* and its graduations are much less steep than those appearing in the Federal Income Tax of 1918 or in other gross sales tax acts effective in the United States at numerous points in their rate structure, as will be shown hereinafter.

III. ANALYSIS OF THE RELATION OF OPERATING STATISTICS TO NET INCOME, SHOWING THAT THE LARGER THE GROSS SALES THE GREATER THE NET INCOME

1. Economics of Large-Scale Retailing

Appellees have pleaded (*J. C. Penney Company Answer, Penney record*, p. 74) that large-scale retail business enterprises enjoy an increased earning power as compared with small-scale businesses by virtue of several well-recognized economic laws, among which are the following:

(1) "It is a well-established and well-recognized law of merchandising economics that the greater the volume of sales the greater the buying power." That this is the case is clearly set forth in affidavits of Morton and Phelps (*Kroger record*, pp. 329-333, 355-359), and in exhibits, Martin—1-5 inclusive (*Kroger record*, pp. 339-340). The common sense of the situation is entirely clear, likewise, since the fact that discounts are offered for large purchases is commonplace in the merchandising field. The fact is also developed, particularly in the testimony of Dr. Phelps beginning on page 355 that, regardless of the effectiveness of cooperation, economies achieved in this respect are not equal to those attained by centralized management, which is found only in large-scale retail enterprises such as appellants in these cases.

Note especially that the advantage of *buying in quantity* is urged by Mr. Lyons, witness for the appellants (*Kroger record*, p. 107) and hence it may be pointed out that, in effect, appellants recognize this contention though they likewise urge that these economies do not arise from the fact that sales are made through multiple outlets. Rather they arise from the large volume of business done. Incidentally, it may be worth while to indicate again that appellees agree cordially with the appellants that this tax is not an imposition on

chain stores as such; the implication in this section of the appellants' brief to the contrary notwithstanding.

(2) The principle is well established that "the ratio of turnover or volume of trade to capital invested increases progressively as volume increases." (*Kroger Answer.*) Appellees have persented substantial statistical evidence concerning this general view, the most impressive, perhaps, being that offered in Martin—Exhibits 6 and 7. (*Kroger record,* pp. 341-342). A study of these tables indicates that, taking all classes of retail businesses together and considering all data reported by the United States Census Bureau in the census of 1930 up to and including January 27, the average rate of inventory turnover gradually increases from around six times annually in one- and two-store enterprises to nine and one-half of ten times annually in large chain stores. It should be emphasized that, as repeatedly pointed out by appellants, chain stores constitute one of the two important classes of large-scale merchandising; and the data presented in Column 5, Table VI, confirms the general proposition. In a general way the showing for all stores in cities like those found in this Commonwealth tends to verify the data.

Turning to Martin—Exhibit 7 (*Kroger record,* p. 342) in which are presented data for grocery and variety stores, it is seen that, in the grocery trade, single-store independents are reported by the United States Census Bureau, Department of Commerce, to have an average turnover of less than 15 annually; whereas sectional and national chains have an average turnover of 19.42 per annum. The showing among variety and general stores is even more clear-cut in this particular than that for grocery stores. The table indicates an average turnover of 4.46 per cent for local variety and general stores and 7.14 per cent for large chains. Again column 5 confirms the general proposition suggested above that these data

are presented in such a way to show significant differences between large-scale and small-scale enterprises. Note that the statistics of cities shown at the bottom of the table verify this with added emphasis.

It may be concluded, therefore, contrary to the contention of appellants, that, according to official United States Department of Commerce findings, there is no question but that turnover increases progressively with volume of business done. There is no doubt but that occasional instances may be cited of small independent merchants who achieve a higher rate of turnover than the average chain, but this has no bearing on the general proposition submitted, since obviously—if Census Bureau facts mean anything—it is an exception to the well established rule. Moreover in the court below appellees' contention is clearly admitted in the following language: "Public patronage has given Kroger a *larger volume of sales and thus enables* Kroger to dispose of its merchandise more rapidly than if it were forced to obtain its profits from a higher price on a smaller volume."

(3) Generally speaking, it is a fact that the amount of income increases with increases in sales volume as Mr. Bonham (*Kroger record,* p. 123) and appellees (Martin—Exhibits 1-5 inclusive (*Kroger record,* pp. 339-340) disclosed, even though Vice-President Bonham goes on, toward the bottom of the same page, to contradict himself in the following language: "My experience is that earnings or net profits do not increase because of an increase in sales volume."

Were the showing of Mr. Bonham that larger gross sales result in a larger *amount* of net profits over that for sales of less volume, this would be adequate to establish the general proposition which defendants have stated and which is generally accepted by tax experts as true (*Affidavit of Walradt, Kroger record,* p. 311). However, it is not necessary to stop here, since data presented

by appellees show beyond question that, large merchants (and that includes all classes which, according to appellants, are subject to the higher rates of taxes under the Kentucky Statute) enjoy a *rate* of net gain in relation both to sales and net worth which increases progressively with increase in the size of the business enterprise. This proposition is re-emphasized in Martin—Exhibit 12 (*Kroger record*, p. 346A), especially in the summary at the end of the second page.

There is no contention on the part of the appellees that the increase in rate of earnings is *precisely the same* as the scheme of graduation provided in the Gross Sales Tax Act. As is shown above, it is not necessary that this be the case. That there is a relationship, however, is demonstrated clearly in these exhibits and in the *Affidavit of Martin* beginning on page 329 of Kroger record.

2. Increase in Net Income with Increase in Sales

The general proposition which the appellees seek to support in connection with the data submitted in Section III of Mr. Martin's evidence (*Kroger record*, p. 329) is that the classification in the Act on the basis of volume of sales is such that rates are properly made progressive, because ability to pay taxes increases progressively with increased volume. This is the fundamental argument. It is supported by the proposition that increased gross sales are typically accompanied not only by larger return on invested capital but even by higher *rate* of return; that increased sales are generally accompanied by more favorable buying opportunities (as shown above); and, as shown below, that the larger the business the lower the rate of tax required to be paid under the hitherto existing tax system. In support of these arguments (which are not concerned with arguments as to *stores* in the case of chain enterprises—because the tax act is not concerned with efficiency comparisons between individual

stores in the case of chain enterprises but with comparisons between the enterprises themselves), appellees submit that the data presented in Martin's evidence beginning at page 329 prove the case adequately. It is further bolstered by Dr. Phelps' testimony, page 355 et seq., in which he shows that, generally speaking, efficiency increases more than in proportion to increased size of the retail enterprise. In this connection, perhaps it should be suggested that the court can not possibly be misled by the reference to an *assumed* ratio of net gains to sales since the witness *assumed nothing* in connection with these exhibits but *presented directly* the results of careful investigation into the actual operating statistics of the merchandising enterprises concerned.

3. Relation of Rate Structure Provided in the Gross Sales Tax Statute to Ability to Pay

As shown in the appellees' evidence (*Affidavits of Walradt and Martin, Kroger record*, pp. 306-307 and 356-357), it is unnecessary to "turn aside from the Act itself and the basis of classification therein prescribed and try to imagine some other grounds for upholding such a law." (*Brief for appellants in court below.*) It must be borne in mind that, as appellants have insisted, "the Act is purely a revenue statute." *Whenever in a purely revenue measure progressive rates are used, the justification for such progressive rates is that they are necessary in order that those taxed may be taxed according to their respective abilities to pay.* There is no other reason for graduation in such a measure, and it is unnecessary to state this in a law itself.

The following quotation from Dr. Walradt, who is an eminent authority in the tax field, is in point:

> "The use of progressive rates in connection with gross sales tax is reasonable since in general

> the larger the gross sales the greater will be the net income of the concern making the sales. Ability to pay is measured by the *absolute* amount of net income received. It matters not from what source the income is received or how large a return is received on capital invested . . . If it is true that, as the amount of gross sales increases, the *amount* of net income resulting increases, then the use of progressive rates in a gross sales tax is justifiable and reasonable." (*Kroger record*, p. 308.)

As clearly indicated in the *primary facts*, submitted in Martin—Exhibits 1-5 inclusive, and 12 (*Kroger record*, pp. 339-340, 346A) retail gross sales in relation to net income generally satisfy Dr. Walradt's conditions. In other words, the classification does rest upon ability to pay and is definitely related to net earnings. It is certainly true that the statute under attack makes gross sales and not net income the actual measure of tax liability. In this connection it is important to make two observations: (1) Gross earnings and gross receipts—that is, gross sales—have long been used by the states and by other countries as a proper measure of ability to pay taxes on the part of businesses. These have been upheld by the courts. (2) As gross sales increase there is a general tendency for net income also to increase. That this is not a universal tendency, does not alter its acceptability as a measure of tax-paying ability.

Many prefer gross sales to net income because of greater ease of determination, greater certainty, and consequent reduced expenses of administration. The test as to whether gross earnings or net, or some other measure of tax liability shall be adopted is a function of the legislature. Appellants have *asserted* that there is no connection between the rate structure provided in the law and ability to pay, but they have not *demonstrated this* contention. On the contrary, as indicated above, it appears that the Act itself definitely implies, if it does

not state, that this is its objective. Moreover, as shown in Section IV of Dr. Martin's affidavit (*Kroger record*, p. 333), the *facts of retail merchandising* confirm the judgment of the Kentucky General Assembly.

In connection with the relation between the rate structure provided and tax-paying capacity on the part of the enterprises subject to the Act, it is important to keep in mind that tax statutes are never so drawn as to guarantee that private business enterprises will be profitable. Indeed they are rarely so drawn as to exempt those businesses which are unsuccessful from tax liability. (Compare, for example, the property tax or the corporation license tax of Kentucky.) That the Gross Sales Tax Law applies to and imposes a burden on Schulte United even though that concern incurred a deficit in 1929 and may have incurred a deficit in 1930 (Martin—Exhibit 13, *Kroger record*, pp. 347-348) is no reason whatever for declaring the statute invalid any more than is the application of the property tax to realty owned by this corporation a reason for the invalidity of the property tax.

As appellees' witnesses have shown (*Kroger record*, pp. 306-307, 329-333, and 355-359), it is true that the businesses enjoying a larger volume have not merely proportionately increased but progressively increased taxable capacity. This assertion is based on concrete factual evidence from experience of many sorts of business enterprises in the exhibits presented, especially Martin—Exhibits 1-5 and 12 (*Kroger record*, pp. 339-340 and 346A). Where this is not the case progressive taxation would generally be out of the question as a matter of justice, but these facts indicate very clearly that in general large-scale businesses *are more profitable* than those operated on a smaller scale. In this connection it may be important to call attention again to the error of appellants' counsel in confusing *credits* or *off-*

sets with *exemptions.* Section four of the Act under consideration *does not provide exemptions;* it does provide credits. Consequently, in constructing the Walradt—Exhibit C (*Kroger record,* pp. 313-317), the witness deals with the situation as prescribed in the statute, treating the section four credits as the law prescribes, and not as the first sentence of section four prohibits, by saying that this tax is not "in lieu of any special State license, excise, occupational or corporation tax." Perhaps it might be well to emphasize again also that the statement that Kroger will pay $113,000 tax; whereas 16,000 merchants pay only $62,000 tax, is inaccurate. The latter figure is the amount paid after allowable credits have been deducted; whereas the figure given for Kroger is the gross item. This is obviously a misleading comparison. Finally, as is clearly shown in Martin—Exhibit 12 (*Kroger reaord,* p.346A), in the summary at the end, that failure to provide for graduation would have the effect of discrimination against the small-scale merchant. It is likewise shown in Martin—Exhibits 1 and 2 (*Kroger record,* p. 339) that small retailers would be clearly subject to unfair discrimination in the absence of reasonably progressive graduation such as that provided in the Kentucky statute.

Again, it is important to emphasize that some such graduation as that provided in this act is necessary as a means of distributing the tax burden reasonably apportioned in relation to ability to pay and, as clearly set forth by appellees' witness, this is true regardless of the source of the income. In general, taxation is imposed upon those who can pay the bill, if it is imposed fairly—whether that ability to pay arises from greater efficiency, better luck, or otherwise. For example, the property tax is levied on those who have property; income taxes are imposed on those who have income (steeply graduated and with very generous initial exemptions in the case of

the Federal income tax so that the great majority of citizens pay nothing under this act); and this act of the 1930 Kentucky Legislature proposes to tax those who enjoy business—the more the business the higher the rate of tax. This method of dealing with the citizen involves no assumption that those subject to heavy taxes are culpable but simply that they have capacity to pay. "The measure is purely a revenue measure."

4. Precedents for Adjustment of Rate Structure to Merchandising Conditions

A study of the testimony of Doctor Walradt shows clearly that the attempt on the part of the Legislature of the Commonwealth of Kentucky to provide a rate structure in this statute corresponding to the merchandising conditions which defendants have shown to obtain is distinctly not without precedent in the tax history of the United States and of other countries. As Doctor Walradt has indicated, such adjustment has on various occasions been secured through the instrumentality of different structural arrangements. In the first place, as pointed out by appellees' witness and as is clearly evident from the statutes, the Federal government of the United States and states like Mississippi and Wisconsin have imposed graduated income taxes. The attempts here have been to secure higher rates of contribution from those who have larger incomes and to do this on precisely the same principle involved in the Kentucky statute. For this purpose it is obviously a matter of indifference whether the precedent be found in Federal or in State practice. As a matter of fact, it is found in both.

In the second place, this adjustment of tax rates in order to levy on those businesses which have greatest taxpaying ability at higher rates has been sometimes achieved by graduation of rates on volume of sales. Per-

haps the best illustrations are those cited by defendants' witness Walradt of the 1881 and 1907 Maine taxes on public utilities of specified classes. It is to be observed that appellants' counsel in the preparation of briefs have studiously avoided any reference to these adjudicated statutes, even though under the 1881 law railroads whose gross receipts (gross sales of transportation service) per mile did not exceed, on the average, $2,250, paid 0.25 per cent of receipts, while roads whose gross receipts averaged over $11,250 per mile were taxed at the rate of *3.25 per cent* of their receipts. Thus, although the gross receipts of the latter class were only about five times those of the former, the tax rate was thirteen times as heavy. This law remained in force until 1907 when changes were made in the rates but none in the principles on which the tax was based.

Comparisons of this Maine act with the Kentucky Gross Sales Tax statute, using Kroger gross sales of $12,000,000 and the gross sales of another enterprise of say $400,000, will reveal that in Kroger's case the effective rate is .94208 per cent of gross sales and in the other .05 per cent. In other words, the rate of tax imposed on Kroger, whose sales are thirty times those of the competitor concern, is less than nineteen times as heavy; whereas, under the Maine law, multiplication of gross sales, by five meant a multiplication of the tax rate by thirteen. Or, to put it another way, in the Maine law the increase in the tax rate was over 2.5 times the increase in gross receipts; whereas under the Kentucky Sales Tax law the increase in the tax rate is slightly over half the increase in the volume of sales.

It appears, therefore, that when—to use the language of appellant counsel, "the court . . . states the law in Kentucky" in the following language, it is, to all intents and purposes, specifically upholding the Kentucky Gross Sales Tax statute; "A license tax may be

graded according to the volume of business done." (*City of Newport* v. *Frankel*, 192 Ky. 408.) Beyond any question, as the preceding discussion has shown, the Kentucky statute does precisely this thing, that is, *graduates the rates in proportion to the volume of business done.*

In explanation, it may be stated that a tax levy is controlled by two factors in the statute imposing the tax. The first is the *base*, which, in the present instance, is the volume of sales. The second is the *rate*, which may be *flat*—as in the Ohio utilities sales tax—or *progressive*—as in the Maine tax of 1881 or the Kentucky Gross Sales Tax of 1930.

It may be concluded, therefore, that appellants' argument to the effect that license taxes may be graduated in proportion to volume of business done without violating the "equal protection of the law's amendment to the Constitution, provided . . . the challenged Act aims at proportional equality of burden," is eminently sound and *settles the question* of *"equal protection of the law" involved here.* That the law aims at *proportional equality of burden* and thus secures equal protection is conclusive from cases cited. It has been shown here, in the light of precedent and in the light of merchandising conditions, that "proportional equality of burden" can be secured by no other method than by some such graduation of rates as provided by the Act now under attack. This conclusion is inevitable from a consideration of Martin—Exhibit 12 (*Kroger record*, p. 346A). (Compare summary-column 10 with summary-columns 11 and 12, and note the following from affidavit by appellees' witness).

> "The typical net result of the imposition of the tax rates prescribed in the Kentucky statute is even more clearly shown in the summary at the end of this table. The most significant part of the summary is found in columns ten, eleven and twelve. Column

ten shows what the average concern having extremely large sales, the average of those having moderately large sales, the average of those having the smallest sales would be before any tax on sales. Column eleven makes it clear that, if a 1 per cent sales tax were applied in Kentucky the larger retailer, typified by those who have presented petitions before the United States District Court, would still have average returns on net worth of 10 to 12.31 per cent, while those having average sales in Kentucky of less than $1,000,000 would be reduced to a decidedly lower rate on owned investment, and the smallest group, on the average, would find itself unable or almost unable to continue in business.

"Examination of column twelve shows that the application of the Kentucky sales tax with the graduated rates prescribed in the statute leaves the largest scale enterprises stil' earning, on the average, 12.49 per cent, the second largest scale, 11.61 per cent, and the third, 9.74 per cent, while the group of smallest merchants have their earnings on proprietorship reduced only to 7.79 per cent."

5. Relation of Rate Structure to Number of Taxpayers and Burden of Tax Imposed

It was asserted by appellants in the trial court that:

"An analysis of Professor Martin's testimony and his exhibits shows that his tables are not only unreliable, but that even if taken to be true, they do not, in any way, tend to substantiate the Answer of the Attorney General, that the ratio of net gain to net sales, or the ratio of net gain to net worth, or the ratio of ad valorem tax to sales or to capital invested, between the large merchant and the small one, is in any way comparable to the ascending scale of rates applied in the Sales Tax Act."

Let us look a little more closely at the analysis of operating results of retail merchants set forth in the

Martin affidavit. Incidentally it is interesting to inquire why appellants did not undertake to "analyze" the testimony in order to show its lack of reliability and equally intriguing that they should use so much space in briefing a case depending on wholly unreliable evidence (as they appear to allege).

A casual glance at Martin—Exhibit I (*Kroger record*, p. 339) shows that specialty stores from 1927 to 1928 which had sales of less than $1,000,000, say an average of $400,000, made a net gain of $9,800; whereas those who had sales of more than $1,000,000, say an average of $1,800,000, had a net gain of $67,000. The tax on the former would average $200; whereas, the tax on the latter would average $11,050. The tax for the merchant having sales of less than $1,000,000 would be $200 out of an income of $9,800 and that on the merchant with average sales of more than $1,000,000 would be $11,050 out of an income of $67,100. This means about 2 per cent of net income in the first case and 16 per cent in the second. Obviously this is not unduly steep graduation. Note that here, as in the cases discussed below, the rates are graduated progressively not flat (as appellants *assume* should be the case). As has been conclusively shown, this is essential if "proportional equality of burden" advocated by appellants is to be secured.

The same situation is shown, though even more clearly, in Martin—Exhibit II (*Kroger record*, p. 339). If one take the unweighted average (mean) rates for those brackets for the three years which are entirely in the less-than $400,000 area, it is found that the average net gain on sales of department stores is nearly 2.6 per cent. The average rate of net gains for the same period in the largest sized stores is just over 5.7 per cent. Assuming that the average of the former group of stores had sales of $200,000 and the average of the group of largest stores had sales of $15,000,000, it is clear from a

simple multiplication that the former had average net gain of $5,200 and the latter of $855,000. The tax on the former would be $100 and on the latter $143,050. Is it not obvious that a merchant earning $855,000 can pay a tax of $143,050 (somewhat over 16 per cent) as readily as another merchant with net gain of only $5,200 can pay $100 (about 2 per cent)? This involves comparison of the smallest-scale merchants with the largest, but comparison of the same type between any two brackets can easily be made. If such analysis be undertaken, it will be disclosed that there is in effect gentle graduation from the smaller department stores up to the larger ones.

Incidentally, it is interesting to inquire how statement of counsel for appellants that, "The evidence of the plaintiff . . . shows conclusively that the plaintiff has never made a greater ratio of net gain to net sales than two to two and one-half per cent," with the oath of Mr. John B. Bonham, Vice-President of complaint corporation, that, "The combined sales of all Kroger stores and the average percentage of profit to said sales during said years was as follows:

	Sales	Average Net Profit
1926	$146,009,373	.0288
1927	161,099,604	.0271
1928	207,373,551	.0257"

(*Affidavit of Bonham,* Kroger record, p. 123). So far as actual data presented are concerned, it appears that it would be more accurate to say that, "Appellants' ratio of net gain to sales had never fallen below 2.5 per cent until after 1928."

If the Court will compare the following clear-cut statement of witness Martin with the confused discussion of his exhibits III to V inclusive on page 340 of the *Kroger record,* it will be possible fairly to judge of the significance of these data which are the actual figures of average operating results of hundreds of retail stores

—even though, according to appellants counsel, they are "theoretical."

> "Exhibit III shows the ratio of net profits to net worth of retail jewelry stores for the year 1927, the only year for which information is available. The exhibit indicates that the least efficient jewelers, speaking in terms of size groups, are those having sales of between $20,000 and $49,000 each. On the average these incurred a loss of 0.7 per cent. The return ranges from this negative quantity on small stores to a positive 3.2 per cent on stores having $500,000 or over of sales. This exhibit may be accepted as a typical example of one of the less efficient retailing groups. It indicates that in no instance is the net return based on the investment of owners particularly generous. It approaches adequacy only in the case of those having net sales of $500,000 or over.
>
> "Exhibit IV shows the relation between net gain and the capital investment, as measured by net worth, of retail specialty stores scattered over the United States. (This is the same group of stores as used in Exhibit I.) Analysis of this exhibit shows that large retailers in the specialty field appear to derive very much greater gains if they are large-scale operators than if they do business on a small scale or relatively small scale.
>
> "Exhibit V shows the ratio of net gain to net worth of department stores, both chain and independent, for the three years ending 1929. In 1927 and 1928 it will be observed that, as the size of the business increases, there is an almost perfectly continuous tendency toward an increase of the rate of net gain to net worth. Even in the abnormal year 1929 this tendency, while not absolutely continuous, is certainly unmistakable."

In connection with the Martin—Exhibit III (*Kroger record*, p. 340), it is desirable to compare appellants' counsel's discussion with the exhibit itself, even though

what appellants admit is fully sufficient to justify the position of the appellees. Appellants' counsel say:

> "Exhibit No. 3 shows the smallest merchant makes a ratio of 2.7% of net profits to net worth, while the largest merchant shown makes a net profit of 3.2% to net worth. In other words, though the large merchant makes only about one and one-half times as much on the ratio of net profits to net worth, the tax imposed is twenty times as much. . . ."

This statement is shown by comparison of the exhibit and the statute to be erroneous in two respects. (1) To take the last first, the tax is not twenty times as much, but much more than twenty times as much, though the rate is less than twenty times as high. It is impossible to say exactly how much higher the rate is, but it is probably not, at most, more than three or four times as high on the average. (2) Examination of the exhibit will indicate that the *weighted average* ratio of net profits to sales (computed directly from the third column of the table and weighted by the number of stores shown in the second column) in those cases to which the lowest rate of tax is exclusively applicable under the Act is 1.2 per cent (not 2.7 per cent) as compared with 3.2 per cent in that bracket to which a rate above .05 per cent is exclusively applicable. That bracket which is partly in the one and partly in the other area, as might be expected, shows an average that is intermediate, that is, 1.9 per cent. It is important to observe that the figures presented here are "net profits," which are the earnings *after paying the owner of the store a reasonable rate of interest,* rather than "net gains," or total net income as defined, for instance, for purposes of the federal income tax. The data for net gains were fortunately available for department stores, which, after all, are a more significant quantity than jewelry stores.

In examining Martin—Exhibit No. IV (*Kroger record*, p. 340), it is of interest to note that while appellants' counsel comment that "there are virtually two classes considered," they select figures from the one year for which three averages are reported. The assertion that the larger stores pay twenty times as much tax is again reiterated, though it is just as inaccurate here as heretofore. The exhibit actually shows an extraordinary difference between the *rate* of income on capital for large and small stores. Furthermore, as shown for all kinds of large-scale retailers in Martin—Exhibit No. XII (*Kroger record*, p. 346A), the difference is *so great* that it would take a substantially more steeply graduated tax than the Kentucky Gross Sales Tax to eliminate the profit motive so far as even *increased rate* of return is concerned; whereas the only thing necessary to induce economic activity, as pointed out by economists generally since the time of Adam Smith and as known to every business man, is that increased business should result in an increased *amount*, not necessarily an increased *rate*, of income. (Note the reiteration of this truth by defendant witness, *Affidavit of Walradt, Kroger record*, p. 306).

To inflict upon the Court a detailed discussion of the comments of appellants counsel on these first five Martin exhibits would be tedious. As a matter of fact, none of the comments reflect in the least on the substantial reliability of the evidence presented, which conclusively demonstrates the contention of the appellees that: (a) As merchants of the several classes considered enjoy a larger volume of sales, they enjoy increased taxpaying ability to an even greater extent than is recognized in the rate structure of the Kentucky Gross Sales Tax Act; and (b) this is the case whether the situation be measured in terms of relation between gross sales and net earnings or rate of net gain on invested capital. If

the average store be assumed to be selling the amount which is at the midpoint of the interval, as reported by the Harvard Bureau and used in the Martin exhibits, the following, based on a comparison of Martin—Exhibit No. I and Martin—Exhibit No. II with the statute, will be of interest (using 1929, the most abnormal year for retailing of those for which data are available):

Average Sales	Ratio of Net Gain to Net Sales	Ratio of Net Gain to Net Sales After Deducting Tax Due Under the Statute
Martin—Exhibit No. I—Specialty Stores:		
$250,000	2.8%	2.7%
1,250,000	3.0	2.6
2,500,000	5.2	4.1
Martin—Exhibit No. II—Department Stores:		
$75,000	3.0%	2.9%
225,000	2.0	1.9
400,000	2.2	2.1
625,000	3.2	3.1
875,000	3.0	2.8
1,500,000	3.1	2.6
3,000,000	3.7	2.9
7,000,000	3.9	3.0
15,000,000	5.3	4.3

From these figures and those presented in Martin—Exhibits IV and V, it is easy to show what the rate of return on net worth amounts to, assuming the same averages as above:

Typical Sales	Net Gain	Net Worth	Net Gain Less Tax	Rate of Net Gain on Net Worth After Tax
SPECIALTY STORES				
$250,000	$7,000	$107,690	$6,750	6.2%
1,250,000	37,500	326,090	32,450	10.0
2,500,000	130,000	928,570	111,950	12.1
DEPARTMENT STORES				
$75,000	$2,250	$35,710	$2,212.5	6.2%
225,000	4,500	90,000	4,337.5	4.9
400,000	8,800	146,670	8,600	5.9
625,000	20,000	294,120	19,350	6.6
875,000	26,250	397,730	24,225	6.1
1,500,000	46,500	553,570	38,450	6.9
3,000,000	111,000	1,460,530	87,950	6.0
7,000,000	373,000	4,604,940	309,950	6.7
15,000,000	795,000	7,035,400	651,950	9.3

This shows a rate of earnings after tax of somewhat less among department stores having sales of $400,000 and less than in the higher brackets, but the remarkable thing is that the graduations in rate of returns are so gentle after the application of the tax. As compared with the figures before the tax shown in Martin—Exhibits Nos. IV and V, there is a decided smoothing out in the rate, but it still is remarkably true that the greater the sales the greater the amount of net income (*Affidavit of Walradt, Kroger record*, p. 306). It could scarcely be asked that a tax law have a fairer incidence than this.

The rate structure is so construed, as set forth above, as to tax alike every retailer who is similarly situated and has the same volume of business. It is of no significance that the number of merchants who must pay the maximum rate *on some part* of their sales is small, since "a classification is not invaiid because it affects one person or corporation alone *where it is broad enough to apply to others if they exist*" (*Cooley on Taxation*, 4th ed., Vol. 1, p. 717).

Obviously the reason for application of the relatively high rates—never, however, as much as 1 per cent —to a comparatively small number of taxpayers is, of course, that there are comparatively few retailers in Kentucky who have sales in excess of $1,000,000. It is to be observed in this connection that the rate structure is so drawn (Walradt—Exhibit C, *Kroger record*, pp. 313-317) that if there were a retailer having a volume four times (or ten times) as great as the largest volume now enjoyed by any Kentucky merchant, he would have to pay a tax at a higher effective rate on sales than would any taxpayer actually affected by the statute. That is to say, the graduation is so provided that there is theoretically no maximum rate. In actual practice, there is no rate effective which would not be exceeded should the taxpayer enjoy an increase in volume of sales. To

put this whole situation in general terms, one may say that the scheme of graduation is entirely comprehensive, even though the effective rate is always less than 1 per cent (as compared with the valid maximum rates on Maine railroads under the 1881 and 1907 laws of 3.25 per cent and 5.5 per cent respectively).

Two other specific points concerning this systematic and entirely natural scheme of graduation appear to cause appellants much mental anquish. First, "Why," they say, "should thirty or forty taxpayers engaged in a legitimate business have foisted upon them the entire burden of the State's obligations?" To this complaint there are at least two entirely satisfactory answers. As a matter of *fact* (*Affidavit of Martin and Brendel, Kroger record,* pp. 100-102), appellants have shown that substantially over 11,000 merchants of the 16,000 reporting have contributed under this Act. Doubtless a considerable number of others will have to pay. This does not look like foisting the entire burden even of this tax on thirty or forty persons. Again, the proceeds of this tax are designed to pay only a distinctly minor proportion of the Commonwealth's obligations. Secondly, the appellants are concerned with the fact that competing concerns operating unit stores will pay a lower tax than will those operating very large stores but having less aggregate sales than those of the numerous unit stores. The answer to this is, of course, that this tax is imposed upon *merchants,* and any merchant enjoying a very large volume of sales must pay it. It is graduated in such way as to conform to the ability of the several *merchants* to pay the tax; and, if the Kroger Company or the J. C. Penney Company enjoys very much larger income than does the Pushins Department Store, it is obvious that the rate of tax ought to be higher than on this small department store. Under the statute this is clearly the case. That there are numerous competing

small stores enjoying a large aggregate volume is of no consequence so far as this tax and most other business taxes are concerned.

6. General Conformity of Rate Structure to Demonstrated Character of Merchandising

In summary, it may be insisted that data presented in this section have shown beyond question that the net income of retailers of each of the several classes in which there are merchants doing both a large and a small-scale business is not only larger in the case of those operating on a large scale than in the case of those operating on a small scale but is at a *higher rate* of volume of sales. It is likewise obvious from data here presented that earnings on capital invested in large-scale enterprises are not only larger in amount but actually represent a distinctly higher *rate of return* than in the case of small businesses. Indeed the *rate of return after the tax* is greater for large than for small-scale enterprises! In other words, the data presented in the Martin exhibits show the arguments so clearly and so conclusively that *it is perfectly apparent* that the larger merchant is able to pay a distinctly higher rate of tax than the smaller. It is equally clear that the scale of rates prescribed in this statute is not graduated with sufficient steepness to impose an undue burden on those subject to higher effective rates. (Martin—Exhibit 12, especially the summary, columns 10, 11 and 12, *Kroger record*, p. 346A.)

Contrary to the contention of appellants, it appears from the first Martin exhibits that retail specialty stores (Martin—Exhibit I) and department stores (Martin—Exhibit II (*Kroger record*, p. 339)—both alike in principle—enjoy not merely larger income when sales are large than when small, but actually a *materially higher rate* of net gain. More significant still, it is shown that retail jewelry stores (Martin—Exhibit III—*Kroger*

record, p. 340) specialty stores (Martin—Exhibit IV) and department stores, both chain and independent, (Martin—Exhibit V—*Kroger record*, p. 340) enjoy a *very much greater* net gain per dollar invested if sales are large than do similar stores having a small volume of sales *per annum*. The point is made clear on the second and third pages of Martin—Exhibit V that this results in the case of department stores both from increasing gross margin and, after moderate size is attained, also from declining expenses of operation. Incidentally, failure of very small stores to make any profit in excess of interest on owned capital (Martin—Exhibit V) may suggest to the Court a reason for the very low initial rates imposed in the statute attacked. Exhibits VI and VII (*Kroger record*, pp. 341-342) show, on the basis of *all* census of distribution data available when they were prepared, that national and sectional chain stores (that is, generally large-scale retailers) have higher turnover, and consequently greater taxpaying capacity—both because this means relatively profitable business, as suggested by appellant Witness Nystrom (*Kroger record*, p. 280) and because it means that these large-scale merchants pay less personal property tax on inventory in proportion to sales than do smaller-scale merchants. That these are generally large-scale retailers is borne out further (if that were necessary) by the sales per store shown in the last column of the exhibits (Martin—Exhibits VI and VII—*Kroger record* pp. 341-342). Of the two exhibits of course the most reliable is VII, which does not involve confusion between different kinds of businesses.

Thus, it is clearly in error to say that the tax act penalizes thrift and subsidizes slip-shod unprogressive merchants. As a matter of fact, this is the stereotyped argument advanced against all tax laws based on taxable capacity which are attacked by those who have substan-

tial ability to pay. According to this view, enterprise, initiative, thrift, foresight, industry, energy and progressive methods are PENALIZED, and slip-shod methods, laziness, stupidity, inertia, and poor judgment are SUBSIDIZED. It sounds very much like a slander against the patriotism of the Legislature. As a matter of actual fact it is essential, if the government is to raise revenue to carry on its functions, that the money be obtained from those who have it. Certainly it cannot be secured from those who do not have it; hence graduated taxes. It appears, therefore, that the difference between "pure theorists" who have testified for appellees and the other brand of theorists who have submitted evidence on behalf of appellants is that the latter have submitted theories fresh from their imaginations (compare for instance *Affidavit of Bonham, Kroger record*, p. 123, where appellants' witness discloses figures contradicting his pure theory to the effect that larger income does not accompany increased volume of sales), while appellees' witnesses have presented *actual facts* with respect to effective rates of this and other comparable tax laws, with respect to the operating experience of merchants, including not only department, departmentized specialty stores, and variety and general stores, but comprehending likewise data collected by the U. S. Government with respect to turnover rates generally. This difference between the manner of presenting evidence by appellants' and appellees' witnesses is doubtless the reason appellants' counsel is so very much exercised over the "complete dearth of primary facts."

IV. THE EXISTING TAX SYSTEM OF KENTUCKY TENDS TO TAX SMALL RETAILERS MORE HEAVILY IN PROPORTION TO SALES THAN LARGER ONES

1. The General Situation

If a Commonwealth raised its revenues by means of

one perfectly administered tax (in practice none are perfectly administered), inequalities would be inevitable, since no one measure of tax-paying capacity takes into account all the necessary considerations to achieve economic equality. The type of discrimination that occurs thus is, of course, not legal discrimination but economic. For example, if the Commonwealth of Kentucky imposed only a well-administered property tax, farmers and public utilities would be taxed with severity while merchants and more especially clerks and professional men would be undertaxed or not taxed at all, because the former require large amounts of property in the operation of their business, while the latter require smaller amounts or none at all. A tax *system*, therefore, must be so constructed that it will employ various measures of taxable capacity, such that all members of the community having ability to pay taxes will make some contribution to the public purse; otherwise, there will be economic inequalities in the incidence of the burden.

Under the tax system already existing prior to the enactment of the Gross Sales Tax Act of 1930, appellees have shown that, in the taxation of retail merchants, substantial inequalities existed. (Section 4 of Dr. Martin's affidavit beginning on p. 333 and pp. 359 and 360 of Dr. Phelps' statement.) In very considerable measure these inequalities are eliminated, or at least substantially reduced, by the Kentucky Sales Tax Act. It has been shown that in the larger retail stores of the several classes for which data concerning Louisville operations are available the discrimination against the smaller retailers is clear-cut; that in department stores in general the large merchant pays a substantially less proportion of his gross receipts in taxes than does the smaller one; that situation is essentially the same whether the business be carried on in multiple-unit stores or in single-unit stores; and that there are clearly definable reasons

for the existing situation. The following quotations from the affidavit of defense witness Martin will very largely serve as an explanation of the situation. (Exhibits referred to in each case are Martin Exhibits.)

"Exhibit IX shows that the taxes on different classes of retail stores operating in Louisville, Kentucky, in 1928 tend to decline as the sales of the store get larger. In the case of drug stores, for example, it will be observed that the very small merchant pays three times as much tax per dollar of sales as the merchant having sales of $100,000 or more. The merchant doing a general grocery business pays about six times as much tax in proportion to sales if he is one of the very small dealers, as he pays if his sales amount to $100,000 or more. The table indicates clearly that the large merchant generally must pay less taxes, relatively speaking, than the small one.

"Exhibit X shows for the years 1927 to 1929 that the same conclusion applied to department stores in general. (Several of these are Kentucky retailers.) Examination of the table in any of the three years for which data are available, indicates that the very large merchant, that is, the merchant having $10,000,000 or more of sales, pays less than one-half as much tax per unit of business as the department store having less than $150,000 of sales. Generally speaking, the gradation is fairly even throughout the several groups.

"On the basis, then, of the information available, it is fair to say that, not only does the large retailer enjoy greater tax-paying ability than the small one, but in actual practice at the present time he appears to pay less tax in proportion to amount of business than does his already handicapped competitor. Therefore, it may be suggested that the graduation of rates in the gross sales tax is justified, not only by greater taxable capacity on the part of the large retailer, but also by the fact that

the payment of larger taxes will tend to equalize the tax burdens already imposed on large and small merchandising enterprises.

"One other point in this connection should be made. Exhibit XI indicates that, taking the country as a whole, the tax burden resting on the department store tends to decline with increase in the scale of operations at about the same rate whether the merchant is independent, a co-operative, or a chain dealer. The tax on the enterprise having $2,000,000 or more of sales is in either instance approximately one-half that imposed on those merchants having less than $500,000 of sales." (*Affidavit of Martin, Kroger record,* pp. 334, 335.)

It remains to supplement the witness' statement only to the extent of pointing out, Martin—Exhibit 12 (*Kroger record,* p. 346A), the application of the rates prescribed in the sales tax statute will not have the effect of removing one type of discriminaton only to substitute another. Indeed it has been shown that the extent of the correction in the incidence of the tax burden is certainly not more than adequate to provide for the utilization of greater tax-paying ability on the part of the large-scale merchant. As a matter of fact, the argument that the effect of the rates will be to offset preexisting inequalities is not essential to the substantiation of the Commonwealth's position but is simply supplementary evidence having large importance, even though the graduation in the Gross Sales Tax Act is insufficiently steep to make it fully effective.

It may be worth while to emphasize one point in the defendant's *Answer* (*Stewart record,* pp. 67–69), which indicated that an economic explanation of the necessity for a graduated tax, if the tax system of the state were to approximate fairness in its incidence, was found in the fact that it offset the regressive effect of the ad valorem tax. It did not suggest that this *license* tax was a *prop-*

erty tax any more than justifying the graduation in the federal income tax (for example) in part by the fact that it offsets the *regressiveness* of the sugar tariff or the tobacco tax implies thereby that the federal income tax is an *import duty or a license tax.* The argument would be almost equally effective assuming the *legal equity* in the property tax contemplated by Section 171 of the *Kentucky Constitution.* Such adjustments by the use of more than one tax in a tax system are essential to conform to ability to pay—the generally accepted criterion of justice in taxation. In order to secure these results the Kentucky Legislature has wisely provided an *additional* tax and not a *substitute* tax. The relief from tax burdens is to be sought rather in the reduction of ad valorem tax rates, than in the subtsitution of one tax for another. Consequently Section 171 of the *Kentucky Constitution* is not even remotely involved in this discussion.

2. Reasons for the Situation Existing Prior to the Passage of the Gross Sales Tax Act

It is possible on the basis of appellees' evidence to indicate clearly the important reasons for the economic discrimination in the tax system of Kentucky as applied to retailers prior to the passage of the Gross Sales Tax Act. In the first place, it is common-place among tax students that large parcels of property are underassessed under the property tax by a larger margin than small parcels. Ordinarily this is the incidental discrimination for the correction of which there is no remedy, except in the improvement of administration. That the situation is widespread, however, is clearly shown—if indeed further showing were necessary—by two recent official publications (U. S. Department of Agriculture, *Technical Bulletin No. 172,* University of Iowa, *Studies in Business, No. 10.* Compare also U. S. Department of

Agriculture, *Progress Report of the Forest Taxation Inquiry, No. 12*).

A second important reason for the situation, existing prior to the enactment of the Act under attack, is the more rapid turnover of large-scale merchants demonstrated clearly in Martin—Exhibits 6 and 7 (*Kroger record*, pp. 341, 342). (The showing in these exhibits is substantiated with emphasis in the Harvard Bureau of Business Research, *Study of Operating Results of Department Stores in 1929*, Tables 7, 12 and 15). The following comments by appellees' witness emphasize and explain the situation.

"If it is true that the large-scale grocer or variety store merchant or the retailer of any other class enjoys greater sales per store and, at the same time, higher rate of turnover, it must follow that, if ad valorem taxes are assessed against different retailers, the small-scale operator will have to pay considerably more per dollar of sales than will the dealer operating on a large scale.

"In Kentucky heretofore, and at the present time, the State and its local subdivisions secure general revenue primarily through the imposition of property taxes; consequently, when the inventory of the large-scale merchant is assessed it will constitute a decidedly less proportion of the total goods sold during the year than will property assessed against the small store owner.

"It should also be observed that since turnover is higher and since in many cases the same warehouse may be used by the large-scale merchant, it is practicable to reduce the amount of goods on hand on July 1, the day as of which ad valorem tax assessments are made, to a minimum figure. Some such reduction undoubtedly takes place in the stores of small merchants, but it is inconceivable that the small independent store is able to do this as effectively as the larger store and particularly the

large multiple-unit retailer." (*Affidavit of Martin, Kroger record*, p. 333).

To this general showing the obvious fact that rapid turnover makes possible reduction of inventory on the tax date may be added. This, of course, is doubly easy for those merchants who operate a large number of stores from the same warehouse. Indeed it is simply one of the elements of efficiency about which appellants have been so insistent.

Finally the greater proportionate burden of property tax resting on small retailers as compared with larger ones results in the case of Kentucky from the fact that those large-scale merchants doing business both within and without Kentucky have, relatively speaking, a very small percentage of their property located in this State. For instance, although 1.58 per cent of the Atlantic and Pacific Tea Company's business, as measured by sales, is carried on in Kentucky, only 1 per cent of its property is found here; of the Kroger sales, 4.41 per cent are made in Kentucky, but only 2.35 per cent of Kroger's property is situated in Kentucky; the S. S. Kresge Company sales amount in Kentucky to 2 per cent of the total, but the company has only .70 per cent of its property in this State; and though Woolworth makes .80 per cent of its sales in Kentucky, it has here only .37 per cent of its property. (Martin--Exhibit 8, *Kroger record*, pp. 344, 345. A careful comparison of the last two columns in this exhibit after this fashion will reveal that the situation described is generally characteristic of the business of those retailers doing business both within and without Kentucky.) The following statement occurring in the affidavit of appellees' witness Martin will further explain the situation.

"Another strong indication that the property tax burden on large retailers is less than that on those doing a small business is provided by Exhibit VIII. A careful

comparison of the last two columns makes it clear that, with rare exceptions, the large-scale dealers doing business both within and without the State of Kentucky have decidedly a larger percentage of business in Kentucky than of property. Indeed, the cases in which the contrary is true are so rare as to suggest that there is some extraordinary reason; and a careful investigation of the situation indicates that this is certainly true, at least in the case of Montgomery Ward and Company, which constitutes the most unexpected variation of this sort.

"An examination of the annual report of this corporation to stockholders indicates that the total net sales of the corporation for the year 1929 were over $267,000,000 and that the total gross sales of chain and department stores operated by the company were at practically $125,000,000; consequently there must be some error in the report to the State Tax Commission indicating aggregate sales of only $60,000,000. If this is the case it is not at all unlikely that the ratio of sales in Kentucky to total sales is higher than that shown in the exhibit. No details concerning the National Bellas Hess Company, the other extraordinary variant, are known, but there is doubtless some peculiar explanation of that company's higher ratio of property in Kentucky than of sales." (*Kroger record*, p. 334.)

In general, it is clear from the evidence that the tax system, prior to the enactment of the Gross Sales Tax Act, imposed a relatively more severe burden of taxation on small than on larger retailers; that this result was brought about by definitely ascertainable causes, which have been set forth above; and that it is corrected, at least in very large part, by the Gross Sales Tax Act.

V. COMPARISON OF TAX-PAYING ABILITY OF VOLUNTARY CHAINS OF SMALL MERCHANTS WITH LARGE-SCALE RETAILERS

Repeatedly in the theorizing of appellants witnesses the proposition is proposed that co-operative associations of small-scale retailers can secure economies of large-scale production exactly equal to those enjoyed by large-scale merchants, such as appellants. It is of some interest in this connection to find Mr. Lyons, the appellants' witness primarily relied upon in this matter, saying that, "The advantages derived by membership in the 'voluntary chains' are PRACTICALLY identical with the advantages enjoyed by the regular 'chain store.'" (*Kroger record*, p. 110.) The loophole provided here is obviously in the word *practically*. In the light of the actual data presented below, the word *practically* appears to be designed to indicate that the voluntary chain secures a position somewhat nearer large-scale retailers than does the small independent without co-operative effort. In any event the following, from the testimony of Dr. Phelps, shows very clearly what the actual facts are so far as investigations have disclosed them.

"It is interesting to ask whether or not independents who are uniting in voluntary associations are able to attain the economies of large scale operation to the same extent as large consolidated enterprises. In theory it would seem, from a superficial examination, that a large number of co-operating independents might secure any and all of the valuable advantages possessed by the large consolidated enterprises. The facts, however, do not confirm such a theory.

"Professor E. Z. Palmer's survey of the prices of independent grocery stores, and chain grocery stores (the chains representing large-scale consolidated enterprises) in Lexington, Kentucky, during the month of March, 1930, showed that the chains in that city were

14.3 per cent below the independents. Furthermore, the survey shows that the four most efficient independents were being undersold 6.3 per cent to 9.2 per cent by the average chain.

"These four most efficient independents were even being undersold three to four per cent by the least efficient chain in the city. Voluntary co-operation of independents evidently did not enable a single independent to meet the competition of even the most inefficient chain in Lexington, Kentucky. The survey of Professor E. Z. Palmer, just referred to, was published in Chain Store Progress, Volume 2, Number 9.

"In 'A Study of the Prices of Chain and Independent Grocers in Chicago,' by Bjorklund and J. L. Palmer, published by the University of Chicago, November, 1930, pages 37 and 38, we find that the so-called voluntary chain or voluntary co-operative group of independent grocers was being undersold 5.04 cents on the dollar by the chains. Professors Bjorklund and Palmer state: 'It is significant to note, however, that they (the voluntary associated grocers) were not experiencing as much success in meeting chain prices as were certain entirely independent merchants.

"The big advantage of the regular chain over the voluntary group of independents, which prevents the latter from achieving the ability and efficiency of the former, is to be found in the fact that the regular chain enjoys the efficiency which comes from military organization in which the ideas, policies, and orders of the management are certain to be carried out promptly, harmoniously, and efficiently by the many units or branches. The voluntary group of small retailers is handicapped by its democratic organization. It is a case of the proverbial efficiency of the military organization or the autocratic government as compared to the proverbial inefficiency of democracy.

"Voluntary co-operation of small retailers in brief does not appear to increase the ability of these smaller retailers so as to place them in the ability class represented by the large-scale consolidated enterprises." (*Kroger record*, p. 358.)

In view of Dr. Phelps' statement concerning the findings in Lexington, Kentucky, it is of particular interest to observe that the Lexington market is that in which appellants particularly complain of competition from voluntary chains. The following is quoted from the affidavit of Gilbert J. Schneider of the Kroger Company (*Kroger record*, pp. 151-152).

"Independent Grocers Alliance is an important voluntary co-operative association operating in the territory over which I have supervision. Independent Grocers Alliance has some stores outside of my district in the State of Kentucky. I believe that if the sales of each of the stores which are members of Independent Grocers Alliance would be aggregated the same as the sales of each Kroger store are aggregated with the sales of every store in the state, that those merchants would fall in the highest bracket and would have to pay a 1 per cent tax. However, the members of co-operative associations pay nothing. In spite of this fact they enjoy the advantages which the stores owned by Kroger have as a result of being members of the Kroger organization. They secure the benefits of mass buying, mass merchandising, mass advertising, and other economics.

"Each member is furnished with window posters and literature in regard to the proper conduct of grocery business the same as Kroger stores are furnished from central headquarters. Special merchandise broadsides and bulletins for sales campaigns are sent to members of Independent Grocers Alliance by the central headquarters. Each member of Independent Grocers Alliance has common newspaper advertising in the City of Lexington,

that is, one advertising article is inserted for all Independent Grocers Alliance stores in the City of Lexington. There is attached, a marked exhibit C, copy of an advertisement that appeared in a Lexington newspaper by Independent Grocers Alliance. The store fronts of each member of Independent Grocers Alliance bear the insignia "I. G. A." They have common store fronts and can be easily recognized as "I. G. A." stores. The central headquarters send special supervisors who co-operate with the retailer in assisting and developing of the business. These supervisors are experts who advise the retailers in regard to proper methods for increasing sales.

"Under the Kentucky Sales Tax Statute, each member of the Independent Grocers Alliance is treated as a separate unit and is not forced to aggregate his sales with the other members of the association. As a result, his deductions relieve him from the payment of any tax. Every Kroger store is a separate unit under its own manager. Separate records are kept for each store. Each store is charged with taxes and rent, and with the goods which it purchases and credited with the sales it makes. However, the Kentucky Sales Tax Statute does not treat the Kroger stores as separate units but aggregates the sales of all the stores, thus subjecting each store to a 1 per cent tax on its gross sales."

Likewise, in the affidavit of Mr. Donahue of the Atlantic & Pacific Tea Company, the competition in Lexington of the Independent Grocers Alliance is emphasized in the following language (*Kroger record*, p. 184):

"In the City of Lexington the Independent Grocers Alliance has common advertising for all of its members. Exhibit "C" is a copy of the newspaper advertising of the United Grocers Alliance in the City of Lexington, Kentucky.

"I am informed and believe that if the gross sales

of all the members of the Independent Grocers Alliance were added together that the tax on each member would be One (1%) Per Cent on sales; that is, if they were taxed in the same manner as the Atlantic & Pacific stores the sales of all members would be added together in order to determine the rate of taxation. In effect, however, the members of the co-operative association, although enjoying all the benefits enjoyed by the Atlantic & Pacific stores under my supervision, pay no tax at all."

(Perhaps it is superfluous again to call attention to the error on the part of witnesses who believe a 1 per cent tax rate might apply to any business under the terms of the Kentucky law. This has been repeatedly shown to be untrue, and we have no wish to be tedious. —Compare statute with Waldradt—Exhibit No. A-1, *Kroger record*, pp. 312A-324B).

Since Lexington appears from appellants' evidence to be the market in which the voluntary chain competition is most embarrassing, it is of particular interest to find that a careful study of comparative prices (*Kroger record*, p. 358) shows that in this city the chain average is 14.3 per cent below the average for independents and *6.3 per cent below the average price charged by the most efficient independent store* in or out of a voluntary chain.

VI. THE QUESTION OF CONFISCATION

1. Situation in General in the Light of Precedent and of Merchandising Conditions

Among the allegations of appellants in their bills asking that the Kentucky Gross Sales Tax Act be declared unconstitutional and void is the proposition that the tax is confiscatory. It is the purpose of this section to show that this allegation is without foundation.

In the first place, appellees have brought before the court evidence of numerous entirely valid tax acts which

impose distinctly higher rates than those contemplated by the Kentucky statute (*Kroger record*, pp. 306-307). It has been shown that gross sales taxes are imposed in Ohio on steam railways and pipe-line companies, for example, at the rate of 4 per cent; California imposes similar taxes on public utilities at a maximum rate of 7.5 per cent (though in this case, but not in others cited, the tax is in lieu of the general property tax); France imposes a gross sales tax on the sale of practically all types of commodities (except luxuries which are subject to a very much higher rate) at the rate of 2 per cent; and Maine imposed on railroads a graduated gross sales tax ranging from .25 per cent to 3.25 per cent of gross receipts under its act of 1881. In 1907, without change in the principle of graduation, rates ranging from .5 per cent to 5.5 per cent of gross receipts were substituted for the lighter rates previously imposed. In 1927 Maine adopted the rate structure still in effect which provides that the gross receipts tax shall be graduated from 3.5 per cent to 5.5 per cent. Similar graduated gross sales taxes apply to receipts of telegraph and telephone companies (rates ranging from 1.25 per cent to 6 per cent) and to street railways (rates ranging from 1.25 to 4 per cent) in Maine.

It appears from these and numerous other cases which might be cited that the maximum rate under the Kentucky statute (amounting, gross, to approximately .95 per cent on the largest retailers doing business in the Commonwealth) is by no means out of the ordinary. Indeed in comparison with these specific cases it is obvious that the highest rates imposed in this Commonwealth are not to be regarded as relatively high rates at all.

It is of particular interest that, although the appellants make some biting remarks about the significance of these precedents, they make no attempt to offer any con-

structive answer to the insistence of appellees that these are very much heavier taxes than the tax sought to be imposed under the Kentucky Statute. The effort seems to be clear-cut to pass off these entirely valid precedents, which the courts have not found confiscatory, as of no significance, but they offer no counter evidence and submit no refutation. The most nearly arbitrary type of graduation which has been imposed, for a long while, namely, that under the gross receipts tax on public utilities in Maine—1881 and 1907 laws—appellants do not even mention. (Note that the 1881 law was sustained by this Court, *Maine* v. *Grand Trunk*, 142 U. S. 217.)

It has been shown above that there is a substantial correlation between the volume of gross sales and the amount of net income of retail merchants. Examination of Martin—Exhib. 12 (*Kroger record*, p. 346A), particularly summary columns 10, 11 and 12, and more especially 10 as compared with column 12, indicates that, far from being confiscatory in the case of concerns having the largest volume of sales, the income of the typical businesses of this type *after the tax* would approximate 12.5 per cent on net worth; in the case of businesses of intermediate sizes, the ratio of net income to net worth would range from about 9.75 per cent to 11.75 per cent; and the smallest groups of corporations, for which data are available, would receive typically a 7.75 per cent return on net worth—the last a lower rate than would be received by any of the larger-scale businesses. In studying this table, it is particularly important to compare figures in the last two columns of the body of the table, namely, those columns showing the ratio of net profit before tax to net worth with the column showing the ratio to profit after the gross sales tax to net worth. This comparison will demonstrate that in no instance does payment of the tax reduce the rate of return on capital of those concerns which are profitable to a figure which

could, by any stretch of imagination, be called confiscation. It is true, of course, that the rate of loss is made greater in the case of corporations which are already incurring a loss, but it is equally true that the state can not undertake to guarantee the profitableness of a business enterprise. The exhibit shows also that a very few enterprises making an almost negligible rate of profit show a loss after the application of the tax. But, as already stated, the tax will in no instance have the effect of confiscating the income—much less the property—of a merchant operating a profitable merchandising enterprise. To put the situation a little differently, unless a concern is already a failure the operation of this Act will not make it one.

Appellants are very much exercised about the theory, or more properly speaking *their theory*, that the statute is aimed at a very small number of fairly large-scale retail enterprises. However, an examination of the statute (Section 2) reveals that the tax is applicable to "every retail merchant," and an analysis of evidence submitted by appellants shows that large numbers of retailers are making contributions under the Act. At the time the evidence was prepared (February 12, 1931) more than 16,000 returns had been made; and that means, of course, that more than 16,000 taxpayers had paid taxes. Owing to the credits permitted under Section 4, net tax payments had been made by about 11,000 of the 16,000. (Not the *forty or fifty* about which appellants are so much concerned. *They had not made reports at all.*) It would appear from the showing of the exhibit presented by appellants that it might have been presented by appellees to show that tax contributions are made by a large number—not by the comparatively few as appellants argue.

2. Confiscation in the Case of the Kroger Company

Appellants have presented evidence (especially Mar-

tin—Exhibits Nos. 15 and 16, *Kroger record*, pp. 352-353) which make it clear that retail grocery chain stores typically earn somewhat more than the average rate of return enjoyed over the past five years by the Kroger Company. Indeed it appears that, of those doing business in Kentucky (See also Martin—Exhibit No. 13, *Kroger record*, p. 349), no others earn income on sales at as low as the Kroger Company. Martin—Exhibit No. 15 shows that in the five-year period the average earnings of four typical grocery chains, selected as such by the Harvard Bureau of Business Research, the average rates approximated 3.5 per cent. Even if the American Stores, which earned unusually high rates of return, be eliminated from the comparison the average still approximates 2.8 per cent. A similar showing is made in the more exhaustive list, selected by Moody's Investors Service as typical and presented in Martin—Exhibit No. 16.

With this showing it is of interest to compare Mr. Robert W. Lyons' (Executive Vice President of the National Chain Store Association) sworn statement to the effect that "the best managed companies in the retail grocery field were able to earn on their large volume of sales only from 1½ per cent to 2 per cent." It would also be of interest to compare this assertion with figures sworn to by Mr. John B. Bonham and incorporated in his affidavit to the effect that the average earnings of the Kroger Company over the immediately preceding four years amounted to approximately 2.6 per cent. Even this rate as shown in Martin—Exhibits Nos. 13, 14, 15 and 16 is apparently *exceeded by the average* retail grocery chain—not to speak at all of the unusually profitable ones, such, for example, as the American Stores.

In the light of Mr. Bonham's testimony that the Kroger Company enjoyed average income of approxi-

mately 2.6 per cent from 1926 to 1929 inclusive and in view of the indication of appellants that *1 per cent on its gross sales is "a fair margin for its business"* it is rather pertinent to inquire how an additional tax burden such as that imposed in the sales tax statute can constitute confiscation. Even if the statute meant an additional payment of approximately .95 per cent—and due to section 4 credits, it clearly means nothing of the kind —a reduction in the profits on sales from 2.6 per cent to 1.65—to use Mr. Bonham's more conservative figure rather than the earnings of 3.5 per cent found by the Harvard Bureau (Martin—Exhibit No. 15)—is far from confiscation. (This is especially true in view of the fact that this would still leave a rate of return on invested capital of 9.4 per cent. Martin—Exhibit No. 14.) Even this maximum rate would still leave the company about 65 per cent greater income than appellants deem fair.

It has been shown that the typical net earnings on gross sales, according to appellants' witness, in the grocery trade amount to not less than 2.6 per cent; while appellees have presented evidence leading to the conclusion that 3.5 per cent would be a more accurate representation of average earnings for the past five years for which data are available. If a table were constructed in the light of these *facts* it would be as follows:

EFFECT OF KENTUCKY SALES TAX ON PROFITS OF CONCERNS WITH VARYING GROSS SALES AND AT VARIOUS PROFITS RATES

Amount of Sales	Total Tax Payable	Net Profit of 2%		Net Profit of 2½%		Net Profit of 3%	
		Before Tax	After Tax	Before Tax	After Tax	Before Tax	After Tax
$400,000	$200	$8,000	$7,800	$10,000	$9,800	$12,000	$11,800
500,000	300	10,000	9,700	12,500	12,200	15,000	14,700
600,000	550	12,000	11,450	15,000	14,450	18,000	17,450
700,000	950	14,000	13,050	17,500	16,550	12,000	20,050
800,000	1,500	16,000	14,500	20,000	18,500	24,000	22,500
900,000	2,200	18,000	15,800	22,500	20,300	27,000	24,800
1,000,000	3,050	20,000	16,950	25,000	21,950	30,000	26,950
2,000,000	13,050	40,000	26,950	50,000	36,950	60,000	46,950
3,000,000	23,050	60,000	36,950	75,000	51,950	90,000	66,950
4,000,000	33,050	80,000	46,950	100,000	66,950	120,000	86,950
5,000,000	43,050	100,000	56,950	125,000	81,950	150,000	106,950
10,000,000	93,050	200,000	106,950	250,000	156,950	300,000	206,950
15,000,000	143,050	300,000	156,950	375,000	231,950	450,000	306,950

In other words, it is clear from the evidence submitted by the appellants, even without introducing that offered by appellees, that the Kroger fear that the Gross Sales Tax Act must have been "intended to break it up" is without foundation in fact.

3. Fairness of Tax Rate in Practice—Not Confiscatory of Property or of Major Part of Income of Any Typical Merchant

It has already been shown that the rate structure provided by the Gross Sales Tax Act is in general conformity with the facts of merchandising and that the maximum rates are not in any sense confiscatory. (Compare rate structure set out in Section 2 with Martin—Exhibits Nos. 12, summary, 13, 14, 15 and 16, *Kroger record*, pp. 346a-353.) To put the matter in another way, the rates are such as to conform approximately to the ability of the several merchants to pay taxes. In view of this fact, appellants' complaint that the Act is not a bona fide revenue measure, contrary to insistence elsewhere that it *is* purely a revenue measure, must be dismissed without very much sympathy. According to the argument presented, no progressive tax is an "honest" tax. For example, the Kentucky inheritance tax imposed at progressive rates is not "honest," since imposing a flat rate of 16 per cent on all estates (16 per cent is the maximum rate prescribed) would secure more revenue. Clearly the Gross Sales Tax Statute is not "honest" in this sense. It represents rather an effort to provide a rate structure which corresponds definitely to ability to pay, and a flat rate equal to the maximum now prescribed would not conform to the ability in the case of either the Kentucky inheritance tax or its gross sales tax.

It is entirely possible that the tax may apply to concerns making little or no profit. That a merchandising enterprise is poorly managed and consequently makes

little or no income is clearly not the concern of the legislature when it is drawing a tax measure. It must make the tax laws so that the rate structure provided will be in conformity with the *typical* facts of merchandising and of business generally. It is so drawn in fact that no substantial number of concerns will be *induced to fail* by virtue of the imposition of the tax. Evidence that the large-scale merchant is typically able to pay a higher rate of tax has been generously presented. Indeed the law of the State of Kentucky has definitely recognized this in another connection (*Gordon* v. *City of Lexington*, 138 Ky. 442).

In general, therefore, confiscation complained of in appellants' Bills is shown by the evidence to be a figment of the imagination. (1) It is clear from the statute and from appellees' evidence that the tax will not confiscate all or a considerable portion of the income of typical retail merchants even assuming that none of the tax can be shifted to consumers in higher prices. In view of this it is, of course, clear that there can be no confiscation of property. (2) It has been repeatedly shown that, contrary to the statement of appellants, no merchant will be subjected to a tax as high as 1 per cent. (3) It is obvious from the evidence presented not only that the Kroger Company will not have its property confiscated by the measure but that its income will remain to a sufficient extent to amount to over 9 per cent on invested capital (Martin—Exhibits Nos. 13, 14, 15 and 16) although Kroger shows the lowest rate of earnings on sales of any important large-scale merchant operating in this Commonwealth.

Clearly the alleged confiscation will not result from the operation of this Act.

ANALYSIS OF APPELLANTS' EVIDENCE

Evidence submitted by appellants, while occupying

a great deal of space, proves relatively little. Consequently it can be discussed briefly and disposed of without long and tedious analysis. It falls roughly into five categories:

I. EVIDENCE CONCERNING PAYMENT OF KENTUCKY WARRANTS

Appellants present in two places an affidavit of Mr. Davis of Louisville indicating that there is sometimes long delay in the payment of warrants issued by the Commonwealth of Kentucky. This matter concerns the adequacy of the remedy at law and has nothing to do with the merits of the case. Consequently this evidence will be dismissed without further comment here.

II. THE QUESTION OF FIRE AND POLICE HAZARD

Several affidavits introduced by appellants tend to show that fire and police hazards are not increased more than proportionately by appellants' businesses. Since, as agreed upon by both parties, the Act is not a police measure, this question is consequently not involved at all. The affidavits may be passed over as of no significance whatever.

III. EXPERT EVIDENCE

Appellants introduced Professor Nystrom of Columbia University, as an expert witness, and his affidavit is submitted beginning on page 278 of *Kroger record.* Speaking generally, Professor Nystrom gives a reasonably fair-minded statement of some of the issues involved in the history and economics of American retailing. His discussion of the effect of chain-store merchandising on small retailers appears to be inspired by misunderstanding of the issues involved in the case, since he deals with the proposition as though the Gross Sales Tax Act were a police measure and apparently assumes

that it is designed for purposes other than those actually stated in its title and body. Professor Nystrom like Mr. Lyons—who testifies both as an expert witness and also apparently as a representative of the chain-store interests—fall into a misinterpretation of the results of investigations carried on by the Harvard Bureau of Business Research. The net profits figures to which Mr. Lyons (*Kroger record*, p. 104) definitely refers, and similar to those for 1929 cited by Mr. Nystrom, are misleading as the witnesses quote them (though examination of Martin—Exhibit 5 will disclose that the same materials have been presented by appellees). Figures quoted by Professor Nystrom are *net profits* figures; and, like those quoted by Mr. Lyons, should be read in the light of the following quotation from *Operating Expenses of Department Stores and Departmentized Specialty Stores in* 1928, Harvard Bureau of Business Research, *Bulletin* 78, page 8, which applies to both 1928 and 1929 data.

> "The term 'net profit' as used throughout this bulletin represents a real net profit over and above salaries of proprietors, partners or executives, rent on owned real estate used in the business, and interest on the net capital investment in the business, as well as out-of-pocket expenses. Thus the net profit figure represents a true net profit on merchandising operations.
>
> "Since the interest charged on owned capital and a part of the rent charged on owned real estate were not actual disbursements, these items were credited back as interest and rentals earned, which, together with other sundry revenues, were added to net profit to arrive at the total net gain. Total net gain also is shown in Table 5 as a percentage of net worth, since many firms desire a comparison of their net earnings not only on a basis of net sales but also in relation to their actual net investment in the business."

Since the term "net gain" is synonymous with busi-

ness net income (for example, for Federal Income tax purposes), appellees have used that term, and show that the average figure which business men use (Martin—Exhibit II) in 1928 was, *according to the report used by Mr. Lyons,* on sales of:

Less than $250,000	2.3 per cent
$250,000— 499,000	3.4 per cent
500,000— 999,000	2.8 per cent
1,000,000— 1,999,000	3.8 per cent
2,000,000— 3,999,000	4.5 per cent
4,000,000—10,000,000	4.8 per cent
10,000,000 and over	5.8 per cent

At least two other executives of appellants' concerns, Mr. McKim (*Kroger record,* p. 231) and Mr. Bonham (*Kroger record,* p. 115), appear in part as expert witnesses. In the actual fact, the same may also be said of appellants' counsel, though the evidence submitted by counsel is not verified. The part of the evidence submitted by these witnesses, which appears to deserve comment, is found mostly in the testimony of Mr. Lyons.

Mr. Lyons' statement, at the top of page 109 of *Kroger record* is misleading unless it is kept in mind rather definitely that the increase in operating expenses of 5.5 per cent about which he speaks is the increase from 18 per cent to 19 per cent of sales. It is not true, as the appellees show, that the Kentucky tax amounts to 1 per cent, as Mr. Lyons suggests, and indeed *asserts* in one place.

Mr. Lyons, after discussion of the relative sizes of retail merchandising plants, asserts that the "percentage of retail merchants who do an annual volume of business of in excess of $400,000 . . . is mathematically certain to be only a fraction of 1 per cent of the total number of merchants." For aught Mr. Lyons actually shows, nothing of the kind is "mathematically certain."

In general, the evidence introduced by the appellants' experts tends to verify the contention of appellees that

large-scale merchandising, although still a minor part of the total retail business, has grown by leaps and bounds in the past several years, thus carrying on business which was formerly carried on by small independent merchants or not at all.

IV. ANALYSIS OF RETURNS TO THE KENTUCKY TAX COMMISSION

The court might assume that the analysis of returns made by Mr. Martin and Mr. Brendel have been submitted by appellees. As a matter of actual fact, the analysis indicates that, although appellees were enjoined from collecting taxes from most of the large-scale retailers, 16,000 taxpayers had made returns on or before February 12, 1931, and that more than two-thirds of these had shown net tax liability. This is rather remarkable in view of the fear of appellants that the burden of the tax would rest on "thirty or forty" taxpayers. This exhibit appears to be distinctly favorable to the appellees in that it shows so large a number of taxpayers reporting subject to a net tax.

Evidence submitted by Mr. Martin and Mr. Brendel indicates incidentally that *of those who had already filed reports* a larger number of cases in which merchants reporting more than $400,000 of sales occured in first and second class cities than in municipalities of smaller size. Appellants are very much concerned over this fact. As a matter of simple logic, however, this is a very good reason why merchants in first and second class cities, if the facts presented are representative, should pay higher rates of tax. It is important to observe that the *classification provided in the Act* is not based on the size or classification of the city but rather on the volume of sales. That it appears to be true that there is a greater number of large taxpayers situated in cities of classes one and

two—if it does *happen* to be true—is of no significance, for this is not the basis of the classification.

Having dealt at length with the evidence introduced by appellants and appellees herein, and having as we believe, conclusively refuted the assertions of fact in many instances having no bearing on the decision of the case, we shall confine ourselves to cases strictly in point. We shall refrain from quoting paragraphs of pure dicta from countless authorities. In reading the vast number of cases cited by the appellants (in the court below) we have waded through long opinions deciding questions bearing no relation whatsoever to the issues here presented, being rewarded eventually by finding in each case some paragraph of dicta, apparently pertinent on the face of it but in many instances having no bearing on the decision of the particular case and in virtually every instance none on the cases at bar.

THE LAW OF THE CASE ON THE MERITS OF THE TAX

I. THE PROVISIONS OF THE ACT ARE NOT ARBITRARY OR DISCRIMINATORY IN VIOLATION OF THE CONSTITUTION OF THE UNITED STATES OR THE CONSTITUTION OF KENTUCKY

The Gross Sales Tax Law provides for a license tax upon all retail merchants within the Commonwealth of Kentucky, except those persons actually engaged in gardening or farming who sell their farm or garden products in this State.

The business of retailing merchandise is properly subject to classification as a unit and to impose a license tax upon retail merchants as a group does not constitute discrimination against them. *Hager* v. *Walker*, 128 Ky. 1, 107 S. W. 254; *City of Louisville* v. *Sagalowski*, 124 S. W. 339; *Schuster* v. *Louisville*, 124 Ky. 189, 89 S. W. 689; *Brown-Forman Co.* v. *Commonwealth*, 125 Ky. 402, 101 S. W. 321; *Strater Bros.* v. *Commonwealth*, 117 Ky.

604, 78 S. W. 871. Nor is the provision exempting farmers and gardeners discriminatory. On the contrary it constitutes an exercise on the part of the Legislature of its right to divide property or the subjects of taxation into reasonable classes within the purview of Section 171 of the Constitution of Kentucky, which provides as follows:

> "The General Assembly shall provide by law an annual tax, which with other resources, shall be sufficient to defray the estimated expenses of the Commonwealth for each fiscal year. Taxes shall be levied and collected for public purposes only *and shall be uniform upon all property of the same class subject to taxation within the territorial limits of the authority levying the tax;* and all taxes shall be levied and collected by general laws.
>
> *"The General Assembly shall have power to divide property into classes and to determine what class or classes of property shall be subject to local taxation, etc."*

This power is recognized by the Court of Appeals of Kentucky in numerous cases, notably *Young* v. *City of Lexington* (*decided November* 7, 1930), 235 Ky. 822, wherein the Court uses the following language:

> "The sole question presented on this appeal is the validity of the license ordinance of the City of Lexington, which imposes an annual license tax of $75.00 upon the business of a 'painting contractor.' The lower court held it valid and from its judgment so adjudging this appeal is prosecuted.
>
> "Section 1 of the Ordinance imposes the tax upon 'each person, firm or corporation doing business in the City of Lexington as a painting contractor.'
>
> "Section 2 defines a 'painting contractor' as: 'each firm consisting of two or more members and each person with one or more employees.' "

In other words a person doing his own painting and not employing any one to assist him was exempted from the license tax. The Court, in upholding that ordinance, said:

> "Is the exemption of individuals, who employ no employees, made by this ordinance in question based on a reasonable classification? We are of the opinion that it is. It is common knowledge that an individual painting contractor who works for himself and has no employees is much restricted in the size and character of the work he can do in the ordinary course of affairs. He necessarily cannot take the size jobs the others can, nor can he take contracts of any size where time is an element in their completion. Even where he meets in competition a partnership composed but of two members, he, ordinarily and as a general rule, cannot do the work as speedily as a firm can, or even perhaps at all. Simple and fundamental rules of economics verify these statements. It is true that perhaps in some instances, and on some jobs, the individual working for himself may prove as efficient as some partnerships of but limited membership or even a corporation with but very few employees. But such instances will be rare, and it is sufficient if a taxing ordinance in its classification reaches and covers the general situation. It is not required to take care of isolated and exceptional individuals. *City of Louisville* v. *Sagalowski & Son,* supra; *City of Irvine* v. *Bergman,* 220 Ky. 804, 295 S. W. 1041. *It is settled that classification based on the volume of business done is based upon reasonable distinctions.* See *City of Newport* v. *Frankel,* 192 Ky. 408, 233 S. W. 884. *Since the classification made by the ordinance here in question is based upon the fundamental fact that individuals laboring for themselves as a rule cannot and in fact do not generally take jobs comparable in size and character to those taken by those who have aid in the work either from employees or other partners, it follows that after all it is based on the*

'volume of business' idea, and being so based, it is valid and not discriminatory." (Italics ours.)

A like decision was reached in *City of Louisville* v. *Sagalowski & Son* (Ky.), 124 S. W. 339, wherein the Court said:

> "It is allowed that the State or the municipality may classify even those of the same occupations, and may impose a different license tax upon each class. All that is required is that the classification shall be a natural and reasonable one, and that the tax imposed shall be the same upon all of the class. It is not necessary that a license or occupational tax shall bear the relationship of uniformity to property tax paid upon property. The constitution does not contemplate that kind of uniformity. The two phases of taxation are wholly different. The *ad valorem* system is the principal plan of taxation in this State. The license system is cumulative, and in addition to the property taxes. They are not related systems and were not intended to be measured one by the other. In the classification of callings selected as the subject of license taxes, the only limitations in the constitution are that there shall be an equality of the burden imposed on all who naturally or reasonably belong to the class, that the tax shall not be confiscatory and shall be imposed by general law for public purposes. Merchandising as an occupation may be taxed upon the license system, *but it does not follow that all merchants must pay the same license fee or that all merchants must be included. They may be separated into grades or classes, regulated by any reasonable and just consideration, which merely makes of them separate classes."* (Italics ours.)

This court has even gone a step farther and has placed its seal of approval upon a classification involving the discrimination between instrumentalities used in the same business and between the employment of men

and women. A statute of the State of Montana imposed a license fee upon hand laundries not employing more than two women and exempted steam laundries. In *Quong Wing* v. *Kirkendall*, 223 U. S. 63, Mr. Justice Holmes, delivering the opinion of the Court, said:

> "A State does not deny the equal protection of the laws merely by adjusting its revenue laws and tax system in such a way as to favor certain industries or forms of industry. Like the United States, although with more restriction and in less degree, a State may carry out a policy, even a policy with which we might disagree. *McLean* v. *Ark.*, 211 U. S. 539, 547; *Armour Packing Co.* v. *Lacy*, 200 U. S. 226, 236, *Connolly* v. *Union Sewer Pipe Co.*, 184 U. S. 540, 562. . . . If Montana deems it advisable to put a lighter burden upon women than upon men with regard to an employment that our people commonly regard as more appropriate for the former, the Fourteenth Amendment does not interfere by creating a fictitious equality where there is a real difference. The particular points to which that difference shall be emphasized by legislation are largely in the power of the State."

The constitutional authority of the General Assembly to classify retail merchants as a group, for the purpose of imposing a license tax cannot be disputed, nor can the right to exempt those who, being actually engaged in farming or gardening, sell their own produce in this State, as not belonging to that class. They occupy the position of the painter in *Young* v. *City of Lexington*, supra, and the language used in that decision is directly applicable to them.

Aside from the exception as above set out, the tax is imposed upon every person, firm, association, co-partnership or corporation opening, establishing, operating or maintaining any store within the Commonwealth for the

purpose of selling goods or wares or merchandise at retail.

Regardless of the confident assertion of appellants to the contrary, this tax is aimed at no individual or group, but is purely a revenue-producing measure graduated in its operation by the volume of business done.

Appellants claim that because the classification and graduation used as a basis for the tax imposed rest wholly upon the amount of annual gross retail sales, the Act is arbitrary and hence violative of the Fourteenth Amendment to the Constitution of the United States and of the Constitution of Kentucky.

It may safely be said that no system of taxation has been more frequently employed or more often upheld than that based upon the power to tax according to the volume of business done. As stated by the Court of Appeals of Kentucky in *Gordon* v. *City of Louisville*, 138 Ky. 442, 128 S. W. 327:

> "In this State we recognize as valid the imposition of license taxes based upon three theories: one being a uniform tax upon all persons engaged in the same business, without any reference to the amount of business done; another that levies a uniform tax upon the volume of business done without changing it in proportion that the business increases, the per cent being the same whether there is realized from the business $1,000.00 or $100,000.00, per annum. And yet another is the division of the general class, as in this case and the Strater case, into separate classes according to the volume of business done, and the imposition of a different tax upon each division into which the class is divided. This last-mentioned scheme is, of course, open, as are all the others, to the objection of inequality; but the inequality is not any greater under this system than it is under the others. Of course in selecting the line that divides the general class into subdivisions

> and taxing persons coming within the provisions of each subdivision a different rating, the divisional lines are necessarily arbitrarily selected by the authorities having power to enact the tax laws as is the tax that those in each division shall pay. But this fact alone is not sufficient to condemn the Act as an unwarranted exercise of legislative authority, if the tax levied upon each class is reasonable, and the lines dividing the class appear to have been made with reasonable regard for the rights of the persons engaged in the business that is thus divided. . . . The first object in the minds of the legislative body was to tax all merchandise brokers. As a secondary condition there came the propriety of dividing them into classes based upon the volume of business done and this classification was manifestly suggested by the fact that the broker who did a small business should not be taxed as much as the one who did a large business. And so the class was divided into divisions, and a different but not unreasonable tax imposed upon each division. The requirement that the broker who does a large business should be required to pay a heavier tax than the broker who does a small business is neither unreasonable nor unjust. And to divide them into classes based on the volume of business done did not, in our opinion, violate the law of uniformity or reasonableness that has often been applied in cases like this."

The Court will bear in mind that this is not a tax on stores, but is, on the contrary, a tax on retail merchants as defined in the Act. The Act specifies that:

> "the words 'retail merchant' as used in this Act shall mean and include each person, firm, association, co-partnership or corporation opening, establishing, operating or maintaining any 'store' as defined herein, for the purpose of selling goods, wares or merchandise at retail in this State, except those actually engaged in gardening or farming and selling garden or farm products raised by them in this State. The term 'store' as used in this Act shall be construed to mean and include any store or stores

> or mercantile establishment or establishments in this State which are owned, operated, maintained or controlled by the same 'retail merchant.' "

It is, therefore, a tax on the volume of business done by the merchant regardless of whether he be an individual, firm or corporation; or whether he owns one store or many stores. The tax is imposed on the aggregate business done by him.

As far back as 1908 the Court of Appeals of Kentucky, speaking through Judge Carroll, in the case of *Hager, Auditor*, v. *Walker*, 128 Ky. 1, 107 S. W. 254, approved the principle of classification based on volume, in this language:

> "The power to tax according to the volume of business done has been upheld by this Court in *Strater Brothers Tobacco Co.* v. *Commonwealth*, 117 Ky. 604, 25 Ky. Law Rep. 1717, 78 S. W. 871, and here again the principle of uniformity was applied, the Court saying: 'We do not think the tax is lacking in the quality of uniformity. It is the same on each person or corporation which manufactures the same quantity of tobacco. The Legislature had the right to impose a graduated license tax. The larger manufacturer is required to pay more than the small one, based upon value of the product manufactured.'"

The Gross Sales Tax Law cannot, therefore, be assailed as arbitrary, because volume of business is the yardstick employed for measuring the amount of the tax due.

The graduated feature, as contained in Section 2 of the Act, was not arrived at capriciously or arbitrarily, but is founded upon sound economic principles, and represents a careful study of tax conditions as they exist in the various industries based upon authenticated national surveys.

This question was discussed at length by the Court of Appeals of Kentucky in *Gordon* v. *City of Louisville*, supra, wherein the Court said:

> "The only question in this case is the validity of an ordinance of the City of Louisville, reading:
>
> " 'That hereafter the following licenses shall be paid into the sinking fund of the City of Louisville for the purposes of the sinking fund, for doing the businesses, following the callings, occupations and professions, or exhibiting the articles hereinafter named, in the City of Louisville. . . .
>
> " 'Every person, firm or corporation engaged in the business of buying, selling or negotiating the purchase or sale of goods, wares and merchandise to merchants or dealers, shall be deemed a merchandise broker, and shall pay an annual license as follows: Merchandise brokers whose business amounts to $300,000 per annum shall pay a license of $50.00 per year; merchandise brokers whose business amounts to more than $200,000 and does not exceed $300,000 per annum shall pay a license of $35.00 per year; merchandise brokers whose business does not exceed $200,000 per annum shall pay a license tax of $25.00 per year.'
>
> "The appellants, who are merchandise brokers, insist this ordinance is invalid because it selects a class and then divides it into subdivisions in an arbitrary and unreasonable manner, thereby imposing upon each class a tax not equal or uniform and not based upon any reasonable principle of classification. . . . But, assuming that the council had authority to select merchandise brokers as a class for taxation, it is insisted that when so selected the tax imposed should be fixed upon such a basis as would make it uniform upon all persons engaged in the business so selected and classified for taxation. Having this proposition in mind, the argument is made that the tax imposed by the ordinance upon merchandise brokers is not equal or uniform, as this class of persons was again arbitrarily divided into different classes and a different license tax imposed

upon each class. As illustrating the inequality and lack of uniformity in the method employed in taxing the three classes into which merchandise brokers are divided, it is pointed out that under the ordinance the broker whose business amounts to $199,000 a year must pay a license fee of $25.00 per annum, while a broker whose business amounts to only $201,000 a year will pay a license tax of $35.00 per annum; that the broker whose business amounts to $299,000 a year only pays a license tax of $35.00, while the broker whose business amounts to $301,000 must pay $50.00 per annum. It is again shown that the merchandise broker whose sales amount to $1,000,000 per year is only required to pay 5 cents on each $1,000, while the broker whose sales amount to $300,000 pays 11 2/3 cents on each $1,000, and the broker whose sales amount to $100,000 and no more must pay at the rate of 25 cents on each $1,000. Inequalities exist in every scheme of license taxation that has ever been devised. It is not possible to invent a system that will operate with perfect equality upon every person upon whom the tax is imposed. This condition is recognized everywhere and by everybody. If a uniform tax was levied upon every person engaged in a certain class of business, as for instance $25 per annum upon each attorney at law, the result would be that the attorney whose income amounted to $10,000 a year, would pay the same license fee as the attorney whose income was $500 per year. And so if the tax levied upon dry goods merchants was graded according to the amount of business done by each, without distinction as to the volume, it would be equally impracticable to adjust it with absolute fairness, because one merchant whose business amounted to $100,000 a year might be required to expend three times as much in securing this volume of business as his neighbor whose sales amounted to an equal sum. Or, if the tax, as in *Strater Bros. Tobacco Co.* v. *Commonwealth,* 117 Ky. 604, 78 S. W. 871, 25 Ky. Law Rep. 1717, was fixed at $1 on each $1,000 of the marketable value of the manufactured product until the value $100,000, and 50 cents on each $1,000 of the

marketable value in excess of the first $100,000, the manufacturer who produced $100,000 would pay $100, and the manufacturer who produced $300,000 in value would only pay $200. Or, in other words, the manufacturer whose product amounted to $300,000 would only pay 66 2/3 cents on each $1,000. Illustrations of this character might be multiplied without number, but the ones noted will serve to illustrate that the problem of working out equality in taxation is one that has never been solved. Acknowledging the existence of this remediless condition, the efforts of courts have been to relieve it as much as possible by requiring taxing authorities to make as little discrimination as conditions will permit."

In substantial accord is the case of *Strater Bros. Tobacco Co.* v. *Commonwealth,* 117 Ky. 604, 78 S. W. 871. An Act of the Legislature provided for a license tax upon the business of manufacturing tobacco, graduated in such manner that for the first $100,000 of business done a tax of $1.00 per thousand should be levied and that for all business in excess of $100,000, the rate should be 50 cents per thousand, as set out in the opinions above cited. This Act was upheld by the Court of Appeals as being neither arbitrary nor discriminatory, in the following language:

"The Legislature had the right to impose a graduated license tax. The larger manufacturer is required to pay more than the smaller one, based upon the value of the product manufactured. If all manufacturers of tobacco, regardless of the manufactured product produced by each, had been made to pay the same license tax, then a more potential argument could be made against the validity of the law for lack of uniformity and inequality of burden that has been made against the law here sought to be enforced."

These Kentucky cases merely constitute re-affirmations of rules announced in earlier cases. They have

never been modified or repealed and stand as the law of this State today.

This court in numerous decisions has announced the propriety of the progressive feature in license taxes based on volume. In *Brushaber* v. *Union Pacific R. R. Co.*, 240 U. S. 1, it was held that while—

> "It is true that it is elaborately insisted that although there be no express constitutional provision prohibiting it, the progressive feature of the tax causes it to transcend the conception of all taxation and to be a mere arbitrary abuse of power, which must be treated as wanting in due process, but the proposition disregards the fact that in the very early history of the Government a progressive tax was imposed by Congress and that such authority was exerted in some, if not all, of the various incomes taxes enacted prior to 1894, to which we have previously adverted."

Clark v. *City of Titusville*, 184 U. S. 329, presents a case absolutely in point which, if there were no other decisions of this Court on this point, would forever put the matter at rest. The City of Titusville, Pa., passed an ordinance imposing a licensee tax on retail merchants progressively increasing in amount upon the volume of gross sales. The scale was as follows:

Class	Business	Tax
1	Over $60,000.00	$100.00
2	$50,000 to 60,000	80.00
3	40,000 to 50,000	70.00
4	30,000 to 40,000	60.00
5	20,000 to 30,000	50.00
6	10,000 to 20,000	35.00
7	5,000 to 10,000	25.00
8	2,500 to 5,000	15.00
9	1,000 to 2,500	10.00
10	1,000	5.00

The ordinance was attacked upon the ground that the progressive scale was prohibitory and arbitrary, but this Court upheld it in the following language:

"The objection that plaintiff makes to the ordinance is, that it classifies by amount or value with the result (1) that the lowest amount or value of property of a class 'is required to pay the same amount of taxes with the highest amount or value of property therein'; (2) that the differences are not in kind but only in amount, or value, and that the taxes decrease in rate or ratio as the value of the class increases; (3) that the so-called classes are subdivisions of a class, and taxes are imposed upon such subdivisions without regard to a common ratio, either as between the several subdivisions, or as between the members of each of the subdivisions. These objections are but the expression of the effect of classification by amount, and have been made before and considered before by this court, and the judgment has been adverse to the contention of plaintiff in error. We do not think that it is necessary to review the cases or enter again into the reasoning upon which they were based.

"Classification by amount came up for consideration and decision in *Magoun* v. *Illinois Trust & Savings Bank*, 170 U. S. 283, and was sustained. That case, plaintiff in error recognizes, may be urged against his contention and attempts to limit its decision to the power of a State over inheritances, and to explain by that power not only the taxes imposed, but the discriminations which were claimed to have resulted from grading the taxes by the amount of the legacy. This, we think, is a misunderstanding of the opinion. The contentions of the parties in the case were extremely opposite. The appellee claimed that the power of the State could be exerted to the extent of making the State the heir of everybody; the appellant asserted a natural right of children to inherit. We expressed no opinion on either contention, but chiefly directed our consideration and decision to the alleged discrimination features of the law in Illinois. We said: Our inquiry must be not what will satisfy the provisions of the state constitutions, but what will satisfy the rule of the Federal Constitution. The power of the States over

successions may be as plenary in the abstract as appellee contends for, nevertheless it must be exerted within the limitations of that Constitution. If the power of devise or of inheritance be a privilege, it must be conferred or regulated by equal laws.'

"The law of Illinois was charged with inequality of operation because of the classes which it created. It was asserted, as it is in the case at bar, that the classes were formed upon arbitrary differences, and the provisions of the statute which fixed the tax upon legacies to strangers to the blood of the intestate were vigorously assailed. Those provisions were as follows:

" 'On each and every hundred dollars of the clear market value of all property and at the same rate for any less amount on all estates of ten thousand dollars and less, three dollars; on all estates over ten thousand dollars and not exceeding twenty thousand dollars, four dollars; on all estates over twenty thousand dollars and not exceeding fifty thousand dollars, five dollars; and on all estates over fifty thousand dollars, six dollars. Provided, that an estate in the above case, which may be valued at a less sum than five hundred dollars, shall not be subject to any duty or tax.'

"Manifestly, there was inequality between the members of different classes, and that was conceded in the opinion, but as manifestly there was equality between the members of each class, and that equality was held to satisfy the Fourteenth Amendment of the Constitution of the United States; and the reasoning by which that conclusion was supported is applicable to the case at bar. We met the contention accurately and squarely that there was no reasonable distinction between the classes. We said:

" 'If there is inequality it must be because the members of a class are arbitrarily made such and burdened as such, upon no distinctions justifying it. This is claimed. It is said that the tax is not in proportion to the amount but varies with the amounts arbitrarily fixed, and hence that an inheritance of $10,000 or less pays 3 per cent, and that one

over $10,000 pays not three per cent, on $10,000, but an increased percentage on the $10,000 as well as on the excess, and it is said, as we have seen, that in consequence one who is given a legacy of $10,000 and one dollar by the deduction of the tax receives $99.04 less than one who is given a legacy of $10,000. But neither of these cases can be said to be contrary to the rule of equality of the Fourteenth Amendment. That rule does not require, as we have seen, exact equality of taxation. It only requires that the law imposing it shall operate on all alike under the same circumstances. The tax is not on money, it is on the right to inherit, and hence a condition of inheritance. The condition is not arbitrary because it is determined by that value; it is not unequal in operation because it does not levy the same percentage on every dollar; does not fail to treat "all alike under like circumstances and conditions, both in the privilege conferred and the liabilities imposed." The jurisdiction of courts is fixed by amounts. The right of appeal is. As was said at bar, the Congress of the United States has classified the right of suitors to come into the United States courts by amounts. Regarding these alone, there is the same inequality that is urged against classification of the Illinois law. All license laws and all specific taxes have in them an element of inequality; nevertheless they are universally imposed, and their legality has never been questioned.'

"Plaintiff in error, however, contends that the tax in the case at bar is a tax on property, not on the privilege to do business, because the final incidence of the tax is on the merchant, and is paid by him. But every tax has its final incidence on some individual. That effect, therefore, cannot be urged to destroy well recognized distinctions. The tax in the case at bar is a tax on the privilege of doing business regulated by the amount of sales, and is not repugnant to the Constitution of the United States."

Similarly this Court has held valid a progressively

increasing State inheritance tax based upon the value or volume inheritance. This was done in the case of *Magoun* v. *Illinois Trust & Savings Bank*, 170 U. S. 283, cited and largely quoted from in the City of Titusville case, hereinbefore set out. The Court there uses the following language:

> "Appellant, however, says: 'The progression is likewise unnecessarily arbitrary if we take the view that the tax is levied on the amount received. . . . Under such an assumption those taking the larger amounts are required to pay a larger rate on the same sums upon which those taking smaller sums pay a smaller rate; that is to say, one who receives a legacy of $10,000 pays 3 per cent, or $300, thus receiving $9,700 net, while one receiving a legacy of $10,001 pays 4 per cent on the whole amount, or $400.04, thus receiving $9,600.96, $99.04 less than the one whose legacy was actually one dollar less valuable. This method is applied throughout the class. Other examples might be stated.' . . .
>
> "These, however, are conceded to be extreme illustrations, and we think, therefore, that they furnish no test of the practical operation of the classification. When the legacies differ in substantial extent, if the rate increases the benefit increases to greater degree. . . .
>
> "We think the classification of the Illinois law was in the power of the legislature to make and the decree of the Circuit Court is affirmed."

This Court has gone even farther. In *Metropolis Theatre* v. *City of Chicago, etc.*, 228 U. S. 61, it sustained the right of a municipality to impose a theatre license tax increasing with the amount of admission charged, on the theory that it was, after all, a tax on volume. The wording used is interesting:

> "In other words, there is a natural relation between the price of admission and revenue, some advantage, certainly, that determines the choice.

> The distinction obtains in every large city of the country. The reason for it must, therefore, be substantial, and if it be so universal in the practice of the business, it would seem not unreasonable if it be adopted as the basis of governmental action. If the action of government have such a basis it cannot be declared to be so palpably arbitrary as to be repugnant to the Fourteenth Amendment. This is the test of its validity, as we have so many times said. We need not cite the cases. It is enough to say that we have tried, so far as the Amendment is concerned, to declare in words, and the cases illustrate by examples, the wide range which legislation has in classifying its objects. To be able to find fault with a law is not to demonstrate its invalidity. It may seem unjust and oppressive, yet be free from judicial interference. The problems of government are practical ones and may justify, if they do not require, rough accommodations—illogical, it may be, and unscientific. But even such criticism should not be hastily expressed. What is best is not always discernible; the wisdom of any choice may be disputed or condemned. Mere errors of government are not subject to our judicial review. It is only its palpably arbitrary exercises which can be declared void under the Fourteenth Amendment; and such judgment cannot be pronounced of the ordinance in controversy."

Like decisions are to be found in the reports of virtually all of the State Courts as well as Federal. *Newton* v. *Atchison*, 31 Kan. 151, 47 Am. Rep. 486, 1 Pac. 288; *New Castle* v. *Cutler*, 156 Sup. Ct. 612; *Goldsmith* v. *Huntsville*, 120 Ala. 182, 24 So. 509; *Strater Bros. Tobacco Co.* v. *Commonwealth*, 117 Ky. 604, 78 S. W. 871; *Cowart* v. *Greenville*, 67 S. C. 35, 45 S. E. 122; *Saks* v. *Birmingham*, 120 Ala. 190, 24 So. 728; *Clark* v. *Titusville*, 184 U. S. 329, 46 L. Ed. 569, 22 Sup. Ct. Rep. 382, affirming 195 Pa. 634, 57 L. R. A. 348, 86 Am. St. Rep. 694, 46 Atl. 286; *Fickler* v. *Taxing District*, 145 U. S. 1, 36 L. Ed. 601, 4 Intes. Com. Rep. 79, 12 Sup. Ct.

Rep. 810; Ex Parte Mount, 66 Cal. 448, 6 Pac. 78; *San Luis Obispo County* v. *Greenberg*, 120 Cal. 300; 52 Pac. 797; Ex Parte Hurl, 49 Cal. 557; *Knisely* v. *Cotterel*, 196 Pa. 614, 50 L. R. A. 86, 40 Atl. 861; *Williamsport* v. *Wenner*, 172 Pa. 173, 33 Atl. 544; *Allentown* v. *Gross*, 132 Pa. 319, 192 Atl. 269.

The authorities cited above effectively refute appellants' charge that the basis of arriving at the amount of the tax due under the Gross Retail Sales Tax Law is arbitrary, and hence violative of the Fourteenth Amendment to the Constitution of the United States and the Constitution of Kentucky.

No portion of the Act has been more vigorously assailed than Section 4 thereof which reads as follows:

> "The license or excise tax levied herein, shall not be in lieu of any special State license, excise, occupational or corporation license tax due under the provisions of any law now in force or that may hereafter be enacted. Should any retail merchant, as defined herein, be liable and pay any special State license, excise, occupational or corporation license tax under the laws now in force, or that may hereafter be enacted, credit may be taken on the tax levied in this Act for the amount of such special license, excise, occupational or corporation license tax so paid, not to exceed the amount of the license or excise tax levied therein."

It is claimed that this section of the Act constitutes an unjust discrimination in favor of the small retail merchants, in that their special license, excise and occupational taxes are, in many instances more than sufficient to render them exempt from the payment of the gross sales tax. Individual retail merchants and firms, likewise claim that the Act discriminates against them in that corporations engaged in competing with them are permitted to take credit for their corporation license tax

and allege that this amounts to an unlawful discrimination in favor of their corporate competitors.

For the purposes of refuting this novel assertion, only one case need be cited—*Green* v. *E. H. Taylor, Jr. & Sons*, 184 Ky. 739, 212 S. W. 924, wherein the facts were as follows:

E. H. Taylor, Jr. & Sons was a domestic corporation engaged in the manufacture of Double Stamp Spirits. Its corporate stock consisted of $1,000,000.00 par value. The provisions of Section 4189a, Kentucky Statutes, were as follows:

> "All corporations having a capital stock divided into shares, organized by or under the laws of this or any other State or Government, owning property or doing business in this State, except . . . corporations which, under existing laws are liable to pay a franchise or license tax, shall pay to this State to be credited to the Sinking Fund, an annual license tax based upon its authorized capital stock, as hereinafter provided."

Section 4981c, Kentucky Statutes, provides that the license tax required by the preceding section should be 50c per each $1,000.00 of its authorized capital stock.

Section 4214a of the Kentucky Statutes, in force at that time, provided as follows:

> "Every corporation, association, company, copartnership or individual engaged in the business or occupation of manufacturing distilled spirits known as whiskey or brandy, or other species of such Double Stamp Spirits in this State, and each owner or proprietor of a bonded warehouse in this State in which such spirits are stored, shall, in addition to the taxes now imposed by law, pay to the Commonwealth of Kentucky a license tax of 2c on each proof gallon of said distilled spirits which is liable for tax to the Federal Government as shown by its official records and the amount of tax due the

State shall be thereby fixed and measured by the State Tax Commission."

The appellee made the first payment of the 2c per gallon tax provided for in Section 4214a, Kentucky Statutes, and paid the same at the proper periods thereafter throughout the entire year. During the following year a Deputy State Revenue Agent demanded of appellee to pay the license tax provided for by 4189a, supra, plus interest and penalties, for the identical period during which it had paid the license tax due under 4214a, Kentucky Statutes. The Court of Appeals in that case said:

> "The evident purpose of the Legislature, as indicated by the language of the Statutes, was to impose upon all corporations a license tax based upon their authorized capital stock, except such as it exempted from the operation of the Statute, and its purpose to exempt those corporations upon which the law at the time imposed a franchise or license tax, is just as evident. Neither could it be concluded that the Legislature intended to impose two license taxes upon such corporations as the appellee, and a Court would not be justified in construing a Statute so as to impose double taxation, unless the terms of the Statute required it. *Merchants Ice & Cold Storage Co.* v. *Commonwealth*, 154 Ky. 453, 157 S. W. 717; *Commonwealth* v. *Ledman*, 127 Ky. 603, 106 S. W. 247. . . . The tax imposed by Section 4189a, supra, is simply and purely a license tax. It is neither a tax upon the property of a corporation nor upon the value of it, but is a license required for its right to do business in the State, and its amount is in accordance with the volume of its authorized capital stock. *Hillman Iron & Land Co.* v. *Commonwealth*, 174 Ky. 759, 192 S. W. 880. The tax imposed by Section 4214a, supra, is likewise a license tax. It is not a tax upon property nor its value *but is a tax regulated as to amount by the volume of business done by the corporation, for the privilege of engaging in the manufacture of Double*

Stamp Spirits, and is imposed by Legislature, which is authorized by Section 181 of the Constitution. Raydure v. *Board of Supervisors,* 183 Ky. 84, 209 S. W. 19. Under other Statutes, such corporations as appellee are required to pay an ad valorem tax upon the value of their property, and such tax, it is presumed, is the one referred to in Section 4214a, supra, when the 2c per gallon tax is imposed in addition to the other taxes then imposed by law. The construction which is here placed upon the two Statutes 4189a and 4214a, supra, tends to preserve that equality in taxation which the constitution guarantees, and also enables force and effect to be given to the clauses of the different Statutes and prevents any repugnancy between them. Hence we conclude that appellee was liable for the license tax of 2c per gallon upon the Spirits produced by it, as provided by Section 4214a, supra, and not liable to the license tax provided by Section 4189a, supra, and the payment of the last mentioned tax was a payment of money for taxes into the Treasurer when such taxes were not due."

The foregoing effectively disposes of the claim made that Section 4 of the challenged Act is discriminatory. Section 4214a of the Kentucky Statutes provided for a license tax on the gross gallonage of distilled spirits. *The Gross Sales Tax Act provides for a license tax on the gross volume of sales of retail merchants.*

Insofar as the contention of individuals and firms that the right of a corporation to take credit for the corporation license tax paid, constitutes a discrimination in favor of the corporation and against such individual or co-partnership, let it be borne in mind that Section 4214a of the Kentucky Statutes provided that every "corporation, association, company, co-partnership or individual engaged in the business or occupation of manufacturing distilled spirits" was liable to the 2c tax on gross gallonage, and that an individual placed as E. H. Taylor, Jr. & Sons was, could not naturally have obtained a credit

or refund of the corporation license tax provided for by Section 4189a, never having been called upon to pay, or paid such a tax. As a matter of fact this argument utterly loses its force when it is borne in mind that in reality corporations are penalized, lawfully it is true, but nevertheless penalized, for the privilege of doing business as corporations. When competing with firms or partnerships they are handicapped by being forced to pay the corporation license tax, which partnerships or individuals engaged in the same character of business do not have to pay. There is no law in this State or in any State of the Union, which prevents a partnership from incorporating itself, and if any individual or partnership resents the fact that corporations are not subjected to illegal double taxation in the Gross Sales Tax Act they can, if they choose, incorporate and themselves be allowed to take credit for the burden which their incorporated competitors have heretofore borne in competition with them.

The contention of appellants that the provisions of the challenged Act are arbitrary, confiscatory or discriminatory and, therefore, in violation of the Constitution of the United States and the Constitution of Kentucky, is completely demolished by the decision of this Court in the case of *State Board of Tax Commissioners of the State of Indiana* v. *Jackson*, 283 U. S. 527-553. The appellee, Jackson, was the owner of two hundred and twenty-five (225) retail grocery stores, all situated in the City of Indianapolis, Indiana. He had a total investment of about Two Hundred Thousand Dollars ($200,000.00), or a capital investment of less than One Thousand Dollars ($1,000.00) per store. The annual gross sales resulting from all stores was approximately One Million Dollars ($1,000,000.00). The annual gross sales of each store averaged less than Five Thousand Dollars ($5,000.00). The challenged Act provided for a

license tax upon retail stores based upon a numerical scale and depended in its graduated features upon the number of stores owned. The rates prescribed are as follows:

> "(1) Upon one store, the annual license fee shall be $3 for each such store; (2) upon two stores or more, but not to exceed five stores, the annual license fee shall be $10 for each such additional store; (3) upon each store in excess of five, but not to exceed ten, the annual license fee shall be $15 for each such additional store; (4) upon each store in excess of ten, but not to exceed twenty, the annual license fee shall be $20 for each such additional store; (5) upon each store in excess of twenty, the annual license fee shall be $25 for each such additional store."

Under the provisions of the Act Jackson was called upon to pay the sum of $5,443.00 annually. The Act was attacked on the theory that it was arbitrary and discriminatory and that the classification was unreasonable and in violation of the Constitution of the United States and the Constitution of the State of Indiana. The position of Jackson was sustained by the trial court. In reversing the judgment, this Court used the following significant language:

> "The principles which govern the decision of this cause are well settled. The power of taxation is fundamental to the very existence of the government of the states. The restriction that it shall not be so exercised as to deny to any the equal protection of the laws does not compel the adoption of an iron rule of equal taxation, nor prevent variety or differences in taxation, or discretion in the selection of subjects, or the classification for taxation of properties, businesses, trades, callings, or occupations. *Bell's Gap R. Co.* v. *Pennsylvania,* 134 U. S. 232, 33 L. Ed. 892, 10 S. Ct. 533; *Southwestern Oil Co.* v.

Texas, 217 U. S. 114, 54 L. Ed. 688, 30 S. Ct. 496; *Brown-Forman Co.* v. *Kentucky,* 217 U. S. 563, 54 L. Ed. 883, 30 S. Ct. 578. *The fact that a statute discriminates in favor of a certain class does not make it arbitrary, if the discrimination is founded upon a reasonable distinction, American Sugar Ref. Co.* v. *Louisiana,* 179 U. S. 89, 45 L. Ed. 102, 21 S. Ct. 43, or if any state of facts reasonably can be conceived to sustain it. *Rast* v. *Van Deman & L. Co.,* 240 U. S. 342, 60 L. Ed. 679, L. R. A. 1917A, 421, 36 S. Ct. 370 Ann. Cas. 1917B, 455; *Quong Wing* v. *Kirkendall,* 223 U. S. 59, 56 L. ed. 350, 32 S. Ct. 192. As was said in *Brown-Forman Co.* v. *Kentucky,* supra (217 U. S. 573, 54 L. Ed. 887, 30 S. Ct. 578):

'A very wide discretion must be conceded to the legislative power of the state in the classification of trades, callings, businesses or occupations which may be subjected to special forms of regulations or taxation through an excise or license tax. If the selection or classification is neither capricious nor arbitrary, and rests upon some reasonable consideration of difference or policy, there is no denial of the equal protection of the law.'

"It is not the function of this court in cases like the present to consider the propriety or justness of the tax, to seek for the motives or to criticize the public policy which prompted the adoption of the legislation. Our duty is to sustain the classification adopted by the legislature if there are substantial differences between the occupations separately classified. Such differences need not be great. The past decisions of the court make this abundantly clear.

. . . . . .

"In view of the numerous distinctions above pointed out between the business of a chain store and other types of store, we cannot pronounce the classification made by the statute to be arbitrary and unreasonable. That there are differences and advantages in favor of the chain store is shown by the number of such chains established and by their astonishing growth. More and more persons, like

the appellee, have found advantages in this method of merchandising and have therefore adopted it."

Under the Indiana Act, Jackson with gross sales aggregating One Million Dollars ($1,000,000.00) was called upon to pay $5,443.00 of taxes annually. Under the challenged Act in the case at bar he would be called upon to pay $3,050.00. The Indiana Act provided a tax graduated upon the number of stores owned, regardless of their size, sales, earning capacity or invested capital. The Court's approval of that Act destroys the argument of the appellants as to the validity, fairness and justice of the Kentucky Gross Sales Tax Law, which is based in its graduated features upon gross sales, since it is conclusively proven that gross sales bear a proper relation to net gain. A considerable portion of appellants' proof was devoted to the proposition that the General Assembly of Kentucky originally introduced a bill in all respects identical with the Indiana law, but that after the decision of the statutory court in the Jackson case, supra, holding that Act unconstitutional, the Legislature became afraid and redrafted the challenged Act, less stringent in its provisions but at the same time unsatisfactory to appellants. The Kentucky Act challenged by the appellants is based upon a sounder economic policy and is fairer in its provisions than the Indiana Act which was sustained by this Court.

II. THE PROVISIONS OF THE ACT ARE NOT CONFISCATORY, OPPRESSIVE OR PROHIBITORY IN VIOLATION OF THE FOURTEENTH AMENDMENT TO THE CONSTITUTION OF THE UNITED STATES OR THE CONSTITUTION OF KENTUCKY

1. The Actual Rate of Taxation Under the Act

From the affidavits and exhibits of the Kroger Grocery & Baking Co., the J. C. Penney Co., the Stewart Dry Goods Co., and Levy Bros., it would appear that the

rate on dealers who have sales of $1,000,000.00 or more is 1% flat, whereas the rate on those who have only $400,000.00 to $1,000,000.00 of sales is graduated so that on the smaller the rate is 0.5% and reaches 1% on sales in excess of $1,000,000.00. The actual fact is that the rates are very much less severe than the petition implies. For example, the rate which Levy Brothers, under the Statute for the year 1930, assuming they have correctly stated taxable sales at $1,253,389.07 and computed the tax to be $5,499.28, would be 0.43%. Again the tax imposed on the J. C. Penney Co. would be 0.54% while that of the Stewart Dry Goods Co. would be 0.74%. Likewise, the Kroger Grocery & Baking Co. would be 0.77%. The tax rate is made considerably less than the apparent 1% by the rates on sales of less than $400,000.00 and by the offsets of license taxes which are permitted by the Statute. A table has been carefully prepared which shows how the Kentucky Gross Sales Tax is computed, and the *effective* rates of the tax from $400,000.00 of gross sales up to $12,000,000.00 of gross sales. (See Walradt—Exhibit C, *Kroger record*, pp. 313-317.) This particular exhibit is of the greatest importance and we carefully invite the Court's attention to it, for the reason that it is necessary that the *effective* rate be constantly kept in mind whenever progressive rates are used in taxation, the increased rates applying only to portions of the total sum taxed. Under the provisions of a tax such as the one in question it is natural to think only in terms of the highest rate applicable, whereas the *actual effective* rate will always be considerably lower. For instance, a retail merchant having gross sales in Kentucky over $1,000,000.00 is not taxed 1% on his gross sales, as might at first hand appear, but as a matter of fact .305% or considerably less than ½ of 1%. As a matter of fact the tax does not reach ½ of 1% until gross sales amount to $1,390,000.00, and does not reach ¾ of 1% until the

gross sales amount to over $2,700,000.00. *And it is to be borne in mind that the figures here quoted do not take into consideration the credits allowed under Secton 4 of the Act.* When such credits are taken into consideration it is unlikely that any retail merchandising enterprises in the State of Kentucky, regardless of size, would conceivably pay more than 82/100 of 1% of its gross sales.

The tax can in no case ever reach the full 1%, and no better argument in favor of the soundness and fairness of the graduated feature of this tax could be offered than the mathematical precision with which it advances in ever lessening amounts after the 1,000,000.00 gross sales point is reached. (See Walradt Exhibit C.) As stated, we particularly request the Court to carefully examine this exhibit. It will be noticed that the advances in the effective rate of the tax as the gross sales increase by $100,000.00 are small, the largest increase being only 632/10,000 of 1%, in the case of the increase in gross sales from $1,000,000.00 to $1,100,000.00. After $2,500,000.00 of gross sales have been reached the rate of increase drops rapidly. This is shown not only by Exhibit C, above referred to, but by Graph Exhibit D (*Kroger record*, p. 318A), which shows the advances in the effective rates of the Kentucky Gross Sales Tax.

That the degree of progression under the Kentucky Gross Sales Tax is not comparable in any with that appearing in the effective rates of the Federal Income tax levied on 1918 incomes is shown by a comparison of Walradt Exhibits A and B (*Kroger record*, pp. 312A and 312B), the former showing the degree of progression of the effective rates under the Kentucky Gross Sales Tax law and the latter showing the rapidity of the progression under the Federal Income Tax Law for 1918. In the preparation of these two charts the comparison is made between the operation of these two taxes upon the

same amount of gross sales under the Kentucky Act and the net income under the Federal Income tax.

A better comparison between these two taxes can be arrived at by not plotting them on a basis of the same amount of gross sales and net income, but rather for that amount of net income which might be expected to result from a given amount of gross sales, and then comparing the two taxes on a purely net income basis. For this purpose charts have been prepared and filed as exhibits herein comparing the effective rates of the 1918 Federal Income tax as compared with the Kentucky Gross Retail Sales Tax, the gross sales under the latter being assumed to produce a 2% net profit. See Walradt Exhibit G; a 3% net profit, see Walradt Exhibit F, and a 4% net profit, see Walradt Exhibit E (*Kroger record*, pp. 319-322). That these estimates of 2%, 3% and 4% of net profits on gross sales are more than conservative can be seen by referring to Martin Exhibit No. 13 (*Kroger record*, pp. 347-348), which shows that the average runs better than 5% (5.3%, to be exact). Of the three exhibits above referred to, Walradt Exhibit No. E, best evidences the comparison, for this reason, but if 5.3%, the accurate figure, instead of 4% were used the illustration would be more effective. Therefore, using Exhibit E (the 4% ratio) as the standard, it will be noted that the actual increase in the tax, as computed for each bracket, is always larger for the Federal Income tax. Even in Exhibit F (the 3% ratio), which shows an abnormally small net profit on gross sales, it is always larger from $1,600,000.00 on gross sales.

If it be contended that the Fourteenth Amendment to the Constitution of the United States has no application to the Federal Income Tax Law because the restriction is imposed upon the State and not the Federal Government, it may be answered that it does not lie within the power of the Congress of the United States

to levy a Federal income or other tax which is arbitrary, confiscatory, oppressive or prohibitory, for the reason that such legislation brings the Act of Congress within the inhibition contained in the Fifth Amendment to the Constitution of the United States.

Inasmuch as the Walradt exhibits, pointing out the fact that the rate of progression under the 1918 Federal Income Tax was much sharper than that occurring in the Kentucky Gross Retail Sales Tax, have been attacked on the ground that the Federal Income Tax Laws form no just basis of comparison because the "equal protection of the laws" clause, appearing in the Fourteenth Amendment, does not appear in the Fifth Amendment, we feel that we should here point out at some length the fact that the same inhibitions are imposed upon the Congress of the United States in enacting tax laws that are laid upon the States.

The Fourteenth Amendment to the Constitution of the United States provides in part, as follows:

> "Nor shall any State deprive any person of life, liberty or property without due process of law."

This portion of the amendment is a prohibition on all State agencies, legislative, judicial and executive. *Palestine Telephone Co.* v. *Palestine* (D. C. Tex. 1924), 1 Fed. (2nd) 349. However, State income taxes, progressively increasing in rate as volume of net income increases, imposed on the incomes of residents, and also non-residents of the State, upon income derived by them from property owned and within the State, and from any trade, business or profession carried on by them within its borders, have been held to be non-violative of this provision, although the rate of progression is as sharp as that appearing in the Federal Income Tax. *Shaffer* v.

Carter (Okl. 1920), 252 U. S. 37, 40 Sup. Ct. 221; *Travis* v. *Yale Mfg. Co.* (N. Y. 1920), 252 U. S. 60.

The Fourteenth Amendment then goes on to say—

> "nor deny to any person within its jurisdiction the equal protection of the laws."

It has been held that the right to the "equal protection of the laws" within the meaning of the above portion of the Amendment is not denied when it is apparent that the same law of course and procedure is applicable to any other person in the State under similar circumstances and conditions. *Tinsley* v. *Anderson* (Tex. 1898), 171 U. S. 106; *Williams* v. *Arkansas* (Ark. 1910), 217 U. S. 79; *Field* v. *Barber Asphalt Paving Co.* (Mo. 1904), 194 U. S. 621; *Atlantic Coast Line Ry. Co.* v. *Coachman* (1910), 59 Fla. 130, 52 Sou. 377; *Owen County Burley Tobacco Society* v. *Brumback* (1908), 180 Ky. 137, 107 S. W. 710; *State* v. *Taylor* (1909), 224 Mo. 393, 123 S. W. 892; *State* v. *Standard Oil Co.* (1909), 218 Mo. 1, 116 S. W. 902—affirmed 224 U. S. 270; *State* v. *Texas R. R. Co.* (Tex. 1912), 143 S. W. 223; *Marshall v. Foote* (Cal. 1927), 252 Pac. 1075; *Proviso School* v. *Oak Park* (Ill. 1926), 153 N. E. 369; *Stone* v. *City of Jefferson* (Mo. 1927), 293 S. W. 780; *Camden Fire Association* v. *Haston* (1926), 153 Tenn. 675, 284 S. W. 905; *State* v. *Quigg* (Fla. 1927), 114 Sou. 859. And whenever a law operates on all persons and property similarly situated "equal protection" cannot be said to be denied. *Watson* v. *Nevin*, 86 Ky. 492—affirmed 128 U. S. 582.

Nor does the "equal protection of the laws" clause of the Fourteenth Amendment prevent the classification of property for taxation—subjecting one kind of property to a different rate; distinguishing between franchises, licenses and privileges, and visible and tangible property, and between real and personal property. *Home Ins. Co.* v. *New York* (N. Y. 1890), 134 U. S. 594;

Southwestern Oil Co. v. *Texas* (Tex. 1910), 217 U. S. 114, 30 S. Ct. 496; *Michigan Telephone Tax Cases* (C. C. Mich. 1911), 185 Fed. 634—affirmed (1913) S. Ct. 833, 229 U. S. 322; *State* v. *Farmers', Etc., Sav. Bank* (1911), 114 Minn. 95, 130 N. W. 445, 851; *Magnolia Bank* v. *Pike County* (1916), 111 Miss. 857, 72 So. 697; *United New Jersey R., etc., Co.* v. *Parker* (1908), 75 N. J. Law 771, 69 Atl. 239; *Bergen, etc., R. Co.* v. *State* (1907), 74 N. J. Law 771, 67 Atl. 668; *Territory* v. *Pinney* (1910), 15 N. M. 625, 114 Pac. 367; *In re Gross Production Tax of Wolverine Oil Co.* (Okl. 1915), 154 Pac. 362; *Heisler* v. *Thomas Colliery Co.* (1922), 274 Pa. 448; 118 Atl. 394; *State* v. *Galveston, etc., R. Co.* (1906), 100 Tex. 152, 97 S. W. 71.

The provisions in the Fourteenth Amendment that no State shall deny to any person within its jurisdiction the "equal protection of the laws" was not intended to prevent a State from adjusting its system of taxation in all proper and reasonable ways. It may, if it chooses, exempt certain classes of property from any taxation at all, such as churches, libraries, and the property of charitable institutions. It may impose different specific taxes upon different trades and professions, and may vary the rates of excise upon various products; it may tax real estate and personal property in a different manner; it may tax visible property only, and not tax securities for payment of money; it may allow deductions for indebtedness, or may not allow them. All such regulations, and those of like character, so long as they proceed within reasonable limits and general usage, are within the discretion of the State Legislature, or the people of the State in framing their constitution. *Bell's Gap R. Co. v. Pennsylvania* (Pa. 1890), 134 U. S. 237, 10 S. Ct. 533.

The only rule of equality in respect to taxation under this Amendment is that it requires that the same

means and methods be applied impartially to all the constituents of each class. *St. Louis, etc., Ry. Co.* v. *Davis* (C. C. Ark. 1904), 132 Fed. 629; *Smith* v. *Stevens* (1910), 173 Ind. 564, 91 N. E. 167.

This, then, constitutes the restrictions placed upon States by the "due process of law" and "equal protection of the laws" clauses of the Fourteenth Amendment to the Constitution of the United States, insofar as they limit the taxing power of a State.

Let us now turn to the Fifth Amendment of the Constitution of the United States, which serves as a check upon the Federal Government in the imposition of Federal taxes, income or otherwise. This amendment reads in part as follows:

> "No person shall . . . be deprived of life, liberty or property without due process of law."

The "process" which is meant in this clause is *Federal* process. In *re Mahon* (D. C. Ky. 1888), 24 Fed. 525—affirmed 127 U. S. 700. See also *People* v. *Gifford* (1921), 54 Cal. Appeals 182, 201 Pac. 469; *Lewis* v. *State Board of Examiners* (1926), 162 Ga. 263; 133 S. E. 469; *Bemis* v. *Guirl Drainage Co.* (Ind. 1914), 182 Ind. 36, 104 N. E. 496; *Nectow* v. *Cambridge* (Mass. 1927), 157 N. E. 618; *New York Co.* v. *N. Y. C. & H. R. Co.* (1920), 267 Pa. 64, 110 Atl. 286, the "due process of law" clauses of the Fifth Amendment and the Fourteenth Amendment have been held to have the same identical meaning. *U. S.* v. *Armstrong* (D. C. Ind. 1920), 265 Fed. 683.

The following language shows clearly that the Fifth Amendment has been construed to place the same restriction upon the Federal Government in exercising its taxing power that the "due process of law" clause and the "equal protection of the laws" clause of the Fourteenth Amendment places upon the States. In substantiation of this, we quote the following:

"The 'due process of law' by which Congress is limited in the Fifth Amendment, and the States by the Fourteenth Amendment, is equivalent to 'the law of the land', and is intended to protect the citizen against arbitrary action, and to secure to all persons equal and impartial justice under the law. *Davidson* v. *New Orleans*, 96 U. S. 97; *Mo. Pac. Ry.* v. *Humes*, 115 U. S. 512. It *seems reasonably clear that the 'due process of law' provision of the Fifth Amendment is broad enough in its scope and purpose, to include the 'equal protection of the laws' which no State may deny to any person under the provisions of the Fourteenth Amendment. Lecker* v. *Texas*, 139 U. S. 462; *Giozza* v. *Tiernary*, 148 U. S. 657. Classification is allowable under these provisions of the Constitution." *U. S. Yount* (D. C. Pa. 1920), 267 Fed. 861.

It, therefore, becomes plain that if the Federal Income Tax of 1918, with its sharply progressive increase in the tax rate, accorded a citizen of the United States "due process of law" and "equal protection of the laws" under the Fifth Amendment, no valid contention can be made that the Kentucky Gross Retail Sales Act violates the "due process of law" clause or the "equal protection of the laws" clause of the Fourteenth Amendment. And it has been specifically held that the Federal Income Tax law did not violate the Constitution. In the case of *Stanton* v. *Baltic Min. Co.*, 240 U. S. 103, 36 Sup. Ct. 278, it was held that the Income Tax progressions of the Act of October 3, 1913, did not deprive a corporation of property without "due process of law" or deny *"equal protection of the laws" because of the progressive increase, nor because of deductions and exemptions allowed individuals and not corporations.*

A like holding, as applied to a gross volume production license tax exacted by the Federal Government, was reached in the case of *Pacific American Fisheries* v. *Territory of Alaska* (Alaska 1925), 269 U. S. 269, wherein

it was held that a graduated license tax imposed by the Federal Government on salmon canneries, beginning with a flat tax of 10c per case, and then imposing an additional tax of 5c per case on all cases in excess of 10,000 and not more than 25,000 produced; and an additional tax of 10c per case on all cases in excess of 25,000 and not more than 40,000 produced; and an additional tax of 15c per case on all cases in excess of 40,000 and not more than 50,000 produced; and all cases in excess of 50,000 produced an additional tax of 20c, was not an arbitrary classification denying to complainants "due process of law" or "equal protection of the laws." The Supreme Court of the United States goes on to say:

> "It is much pressed that the tax discriminates against large canneries in favor of small ones—this especially as to contravening the 5th Amendment and denying 'due process of law.' Classification of taxes by the amount of the corpus taxed has been sustained in various connections heretofore. By way of specific answer it is pointed out by the Attorney General of Alaska that the size of the run of salmon cannot be foreseen; that a cannery must be prepared to its full capacity; *that there always will be an irreducible minimum of expense to be borne, whatever the size of the pack; that therefore a small pack may mean a loss and a larger one a profit, and that on these considerations the law justly may attempt to proportion the tax to the probable gains. The inequalities of the tax are based upon intelligible grounds of policy and cannot be said to deny the petitioner its constitutional rights.*"

If the tax had been imposed by a State and the case had gone before the Supreme Court of the United States a like decision would have been reached, because, as heretofore set out, the Fifth Amendment to the Constitution of the United States imposes the same restric-

tion upon the Federal Government that the Fourteenth Amendment does upon the States. The language—

> "the law justly may attempt to proportion the tax to the probable gains,"

bears out the contention of appellees in the instant case, that it is entirely proper to proportion a tax to probable gains based on gross volume of business. Just because the companies whose affidavits appear in this record are not earning a net amount on their gross sales, such as the general average as shown in the exhibit, is no reason for holding the Kentucky Gross Sales Tax confiscatory. In the case of large concerns properly managed that exhibit, taken from the records on file in the State Tax Commission and other unimpeachable sources and representing a fair cross section of the large retailers in this State, shows the average net profit on gross sales to be 5.3% on business conducted throughout the nation; it shows the return on the capital investment in Kentucky, before paying the gross sales tax, to be 42.5% on the amount of property invested in this State; and after the payment of the gross sales tax according to the rates which these companies will have to pay, it shows the net return on the capital investment to average 41.2%. To say that the levying of a tax which leaves thirty-four of the largest retail merchandising enterprises in the State of Kentucky making an average of 41.2% annually on their property invested in the State of Kentucky, after payment of the tax, is confiscatory, is absurd on the face of it.

The Court will here note that both the Kroger Grocery & Baking Company and the J. C. Penney Co. appear on this chart. The chart speaks as of 1929 because of the fact that complete 1930 returns were not available at the time this case was decided by the lower court, and for the additional reason, as heretofore pointed out in

this brief, that the Kroger Co.'s earning for 1930 do not reflect the general condition of the industry, but rather are indicative of internal disaffection, mis-management, lack of efficiency, or an organized price-cutting campaign to stifle competition. A comparison of the figures embraced on that chart, with those set out in the record, will show that the Great Atlantic and Pacific Tea Company showed a substantial increase over the year 1929, whereas the Kroger Co.'s net earnings were cut to about one-third of the 1929 earnings.

It is strenuously argued in the affidavits filed on behalf of the Kroger Grocery & Baking Co. and the J. C. Penney Co., that voluntary associations of independent merchants enjoy all the benefits which accrue to large scale merchants enjoying a tremendous volume of business. It is asserted that such organizations as the I. G. A. (Independent Grocers Aliance) enable independent merchants to obtain the same purchasing discounts, rapidity of turnover, low operating expenses and high return on captal invested that large chain stores have, without being subjected to the burden of the Gross Retail Sales Tax Act, solely because they are independently owned stores.

This is a very adroit argument, but one which will not withstand an examination based upon proven facts. These voluntary associatons, lacking as they are in the capital structure and unified management and control, are wholly unable to match their large chain competitors, either in purchasing discounts or in the return on their property invested. This latter is substantiated by the charts of Dr. Martin.

Insofar as the former is concerned, no better evidence of just what these little independent co-operative associations are met with when they try to meet chain competition in buying can be afforded than the facts as they were brought out in the case of *National*

Biscuit Co. v. *Federal Trade Commission,* 299 Fed. 733. In that case the facts were as follows: The National Biscuit Co. manufactures bakery products and has a business policy of allowing the following discounts: (a) customers whose purchases from the company in a calendar month are under $15, pay list prices with no discount; (b) customers whose purchases from the company during the calendar month aggregate $15 or more, receive a quantity discount of 5% (c) customers whose purchases from the company in a calendar month aggregate $50 or more, receive a quantity discount of 10%; (d) customers whose purchases from the company in a calendar month aggregate $200 or more, receive a quantity discount of 15%; for payment in cash a 1% discount is given to all customers and no customer under any circumstances receives any greater quantity discount than 15%.

The Federal Trade Commission entered an order directed at petitioners requiring them to cease and desist

> "from giving to purchasers operating two or more separate units or retail grocery stores of chain systems a discount on the gross purchases of all the separate units or retail stores of such chain system, where the same or a similar discount on gross purchases is not allowed or given to associations or combinations of independent grocers operating retail grocery stores similar to the separate units or stores of such chain system."

The evidence showed that the National Biscuit Co. had approximately 51.6% of the entire biscuit and cracker business in this country, and that the Loose Wiles Biscuit Co., to whom a similar order was directed by the Federal Trade Commission, enjoyed 15% of the entire cracker and biscuit business in the United States. The Court, in reversing the order of the Federal Trade Commission, and thereby denying to co-operative asso-

ciations of independent gocers the right to pool the independent's purchasing power in order to obtain discount such as chain stores receive, uses the following language:

> "We conclude that the sales policy of the petitioners 'National Biscuit Co. and Loose Wiles Co.' as to their discount plan, as well as the refusal to sell co-operative or pooling buyers, is fair in all respects as to all its competitors and customers, . . . It is a practice which is recognized by manufacturers of bakery products and is inoffensive to good business morals. It was an error to direct the petitioners to sell to individual grocers who pooled their orders or purchase or who bought on a co-operative basis. . . . A manufacturer of biscuits cannot be expected to adopt a uniform policy that is appropriate to meet the small buyer and large buyer. . . . The manager of the pool, when it has a manager, merely buys as an agent or employee of the pool. He has no control over any of the various grocers in the pool. He incurs no liability. Each member of the pool controls his own business, *and is liable for his own debts.* The case is different where the sale is made direct to the manager of a chain unit. . . . For these reasons we regard the order—against each of the petitioners—as improvidently granted and the orders complained of are reversed."

The net result of this has been that co-operative associations are precluded from receiving the large purchasing discounts, which chain stores uniformly obtain. As a consequence, Dr. Martin, in his affidavit, states that a survey made in the city of Lexington, Kentucky, indicates that the most efficient of the small retailers, ***including those in the co-operative organizations in the spring of 1930 were forced to sell at price levels 3 or 4% higher than the prices charged by the least efficient large-scale retailer.***

III. THE ACT IS NOT VIOLATIVE OF ARTICLE I, SECTION 8, SUBSECTION 3, OF THE CONSTITUTION OF THE UNITED STATES, COMMONLY KNOWN AS "THE INTERSTATE COMMERCE CLAUSE"

It is claimed by appellants that the Gross Retail Sales Tax Law violates the provisions of Article One, Section Eight, Subsection Three of the Constitution of the United States, which reads as follows:

> "The Congress shall have power . . . to regulate commerce with foreign nations and among the several States, and with the Indian Tribes,"

because it discriminates between farmers or gardeners living without the State of Kentucky and selling their produce within said State, and those farmers or gardeners living within the State of Kentucky and selling their produce within, thereby imposing a burden on interstate commerce. To put it another way, it is contended that the law constitutes an attempt to burden, interfere with and regulate interstate trade and commerce and to levy and impose a tax upon the importation of farm and garden products raised and grown outside of the Commonwealth of Kentucky, and brought into the Commonwealth for sale in stores therein.

It has been repeatedly held, that the Interstate Commerce Clause of the Constitution has no application to sales of goods in a State when it appears that the goods were manufactured or grown in another State, shipped in quantity into the taxing State, and from there sold in retail orders by the manufacturer or producer. *Duncan* v. *State*, 105 Ga. 457, 30 S. E. 755; *Kehrer* v. *Stewart*, 117 Ga. 467, 44 S. E. 854; *Muskegon* v. *Zeeryp*, 134 Mich. 181, 96 N. W. 502; *Emert* v. *Missouri*, 146 U. S. 296, 15 Sup. Ct. Rep. 367.

The interstate commerce feature plays no part whatsoever in the constitutionality of this act, even admitting

the construction placed upon the wording of the Act by appellants.

However, if the Act either read or meant what appellants have conceived it to, as above set out, that portion of it would, in all probability, be repugnant to Amendment Fourteen, Section One of the Constitution of the United States which provides that:

> "No State shall make or enforce any law which shall abridge the privileges or immunities of citizens of the United States."

This clause of the Fourteenth Amendment has been construed to prevent a State from extending any license tax exemption to its own citizens, which is denied to a nonresident, unless the grant of exemption be founded upon some reasonable exercise of the police power. *American Fertilizer Co. v. Board of Agriculture* (Circuit Court of Appeals of North Carolina), 43 Fed. 609. There are many cases to this effect. However, the language of the Act—

> "The words 'retail merchants' . . . shall mean . . . every person . . . maintaining any . . . 'store' . . . for the purpose of . . . selling . . . merchandise at retail in this State; except those actually engaged in gardening or farming and selling garden or farm products raised by them in this State."—

means that persons actually engaged in gardening or farming and *selling in this State*, garden and farm products raised by them are exempt, the words "in this State" referring to the word "selling" and not to the word "raised." This portion of the sentence is not punctuated and if properly punctuated to express its meaning it would read, "except those actually engaged in gardening or farming, and selling garden or farm products, raised by them, in this State."

In other words, under a fair construction of this Act, one actually engaged in gardening or farming in the State of Ohio, or any other State of the Union for that matter, has a right to, himself sell in his store in Kentucky, farm or garden produce so raised by him, without being subject to the imposition of the Gross Retail Sales Tax Law.

Even if the language of the act were ambiguous and capable of two constructions, it is fundamental that the Court should place upon it such a construction as will uphold its validity rather than invalidate it. But aside from this, it is perfectly clear that the words "in this State" in the last part of the sentence above set out refer to "selling," just as the words "in this State" in the first part of the same sentence refer to "selling." Any other constructon would amount to a distortion of the plain language and intent of the Legislature.

In addition, it is suggested that the Act is violative of the Interstate Commerce Clause of the Federal Constitution, because the Act indirectly taxes the sale of products moving in Interstate Commerce. In other words, it is contended that certain department stores, such as Stewart Dry Goods Co., have many accounts with persons residing without the State of Kentucky, who order goods from it, either by telephone or mail. The orders are filled by shipment or delivery to these customers. We would again call attention of the Court to the language of Section 1 of the Act which provides:

> "The words 'retail merchant' as used in this Act shall mean and include every person, firm, association, co-partnership or corporation, opening, establishing, operating or maintaining any 'single store' as defined herein, for the purpose of and *selling goods*, wares or merchandise at retail in this State, except, etc."

Manifestly the foregoing language says as plainly

as words can be put, that the tax is imposed on retail merchants selling goods in this State and does not apply to sales made without the confines of the State of Kentucky, or of such a character as would come within the purview of the Interstate Commerce Clause of the Constitution; that the words "in this State" in the section above quoted refer to the word "selling" and not the word "store" is made doubly clear by the next sentence which says:

> "The term 'store' as used in this Act shall be construed to mean and include any store or stores or any mercantile establishment and establishments in this State, etc."

Therefore, in the purest verbiage imaginable the Act says that a retail merchant operating a store in this State and selling goods in this State must pay a tax on his gross sales.

We do not deem it necessary to cite cases to this Court in substantiation of the proposition that a sale by a store in Kentucky to a purchaser in Kentucky has no bearing whatsoever on Interstate Commerce.

It is utterly impossible to interject the question of any burden on Interstate Commerce under the provisions of this Act, without utterly distorting the wording of the Act and destroying its plain meaning and intent.

Undoubtedly, the appellants will not deny the well established rule that the Federal Courts in construing a State statute are bound by the construction placed thereon by the highest court of the State. The validity of the challenged Act involved in the case at bar was before the Kentucky Court of Appeals in the case of *Moore et al* v. *State Board of Charities and Corrections, et al,* 239 Ky. 729, 40 S. W. (2d) 349. The constitutionality of the Act was challenged on the following grounds: (1) It denies the equal protection of the law to the various classes of

taxpayers who come within its purview; (2) It is confiscatory; (3) It violates the commerce clause of the Federal Constitution. The Court in a well reasoned opinion sustained the constitutionality of the Act and specifically decided that its provisions do not deny the equal protection of the law to the various classes of taxpayers who come within its purview, that the Act was not confiscatory and did not violate the commerce clause of the Federal Constitution. We await with interest appellants' brief to learn how they will attempt to escape the opinion of the Kentucky Court of Appeals sustaining the constitutionality of the challenged Act.

For the reasons assigned we submit that the judgment of the lower court should be affirmed.

Respectfully submitted,

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